April 1958

THE CANADIAN CHARTERED ACCOUNTANT

Brokers' Records

Reviving a Declining Business

Estate Planning and Business Continuity

Controlling Food Costs in Industrial Catering

The Floating Charge - Cinderella Security

Operation Banking

ADMINISTRATIVE ACCOUNTING: Corporate Financing

ACCOUNTING RESEARCH: "Market" in Inventory Valuation

TAX REVIEW: Expenses of Officers and Employees

THE CANADIAN
CHARTERED ACCOUNTANT

VOL. 72, No. 4 APRIL 1958

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MONTHLY FEATURES

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IN THIS ISSUE

FRANK WILLCOX, C.A. (page 309)

Few experiences in business are as rewarding as the satisfaction of transforming a failing business into a sound profitable one. Such a change can be achieved in various ways and, in "Reviving a Declining Business", Frank Willcox deals effectively with two of them — the "quick" and the "calculated" approach. Both, he claims, can be related to the condition of the industry in which the company is engaged and to the position of the company in that industry. The author stresses that it is not enough to eliminate the cause of the decline but that steps must also be taken, once the company has been brought back from a negative to a neutral position, to develop a program for an assured future.

Mr. Willcox is a partner in the firm of Price Waterhouse & Co., Montreal and, during the past six years, has been engaged in the work of its management advisory services. An associate of the Canadian Institute of Mining and Metallurgy, he has been active on a number of its committees and is a past chairman of the Montreal Branch. He is the author of two books in this field "Metal Mining Company Accounting and Administration" and "Mine Accounting and Financial Administration". Mr. Willcox was admitted to the Institute of Chartered Accountants of Quebec in 1933 and to the Institute of Chartered Accountants of Alberta in 1951. He is also a Fellow of the Chartered Institute of Secretaries.

W. GRANT ROSS, C.A. (page 316)

"Brokers' Records" deals with a topic of key importance to those engaged in the stock brokerage business: the need for specialized records to meet legal requirements and to maintain an adequate system of internal control. In many respects, accounting for the stock brokerage business follows the standard principles set up for other businesses but few companies are more subject to the dangers of misappropriation. Thus, the problem inevitably arises of how best to maintain a record-keeping system designed for efficient controls and to satisfy the demand for up-to-the-minute information on brokerage companies' activities.

Mr. Ross joined Clarkson, Gordon & Co., Toronto, in 1933 and received his certificate in chartered accountancy in 1937. Eight years later he was admitted to partnership and opened the firm's Vancouver office. He served for five years on the Council of the Institute of Chartered Accountants of British Columbia and is a past president of that Institute. In 1953 he returned to Toronto. Active in community affairs, he has recently been appointed chairman of the corporation special gifts division of the United Appeal for Metropolitan Toronto for the 1958 campaign.

WINSLOW BENSON (page 325)

There has been a marked increase in the offering of Canadian corporation obligations secured by a floating charge or secured debenture only and, while first mortgage bonds and unsecured debentures continue to be the main instruments for corporate borrowing, this new form for securing corporation debt is receiving more and more recognition. In "The Floating Charge — Cinderella Security",

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Winslow Benson examines the merits of this form of security and finds reasons why it promises to play a much more prominent role in Canadian corporate finance.

Mr. Benson is manager of the corporate trust department of National Trust Company Limited in Toronto and the author of "Business Methods of Canadian Trust Companies" (Ryerson 1949). He graduated in law from the University of Saskatchewan and, since joining National Trust in 1925, has served with the company in its Saskatoon, Hamilton and Toronto offices.

S. R. SMITH, C.A. (page 331)

The business of feeding people ranks high in the top industries of Canada. Successful management in industrial catering, where employees eat in the plant, is equally important, for well-prepared food, fast service and attractive prices make for better employee relations and a more satisfied and contented staff. In "Controlling Costs in Industrial Catering", Stanley R. Smith explores those areas in which cost control plays such a vital part in this type of operation.

Mr. Smith is a partner in Wilton C. Eddis & Sons, Toronto, and obtained his certificate in chartered accountancy in 1950. He is a member of the Institute of Chartered Accountants of Ontario and the Society of Industrial and Cost Accountants.

IRVING ROSEN (page 339)

Interest in estate planning is growing. Accountants are now playing a greater role in helping the businessman with estate problems and they readily agree that much can be done to control the disintegration of a business which so often happens when its

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owner dies. In "Estate Planning and Business Continuity", Irving Rosen presents a number of case histories to show what provisions can be made to enable a company to continue to operate to the ultimate benefit of the deceased's beneficiaries. He reaches the conclusion that action can be taken before disaster strikes to see that the beneficiaries or other working partners continue to have an income-producing organization.

Mr. Rosen is secretary of the Chartered Accountants Student Association of Ontario and a fifth year student-in-accounts with Duckman, Kurtz, Resnick & Co., Toronto. Last year he won the Canadian and Ontario Institutes' silver medals for obtaining the highest marks in Canada and Ontario respectively in the C.A. intermediate examinations.

EDITORIAL (page 307)

The underlying note in this month's editorial "The Accountant's Role in Estate Planning" by A. D. Stanley is that much of the work of estate planning can be done by an accountant without fear of treading on any toes. He can assist his client in such ways as planning a program of gifts, deciding whether or not a personal corporation would be useful and considering the implications of accumulated corporate surplus. These are important aspects in any estate planning program.

Mr. Stanley is president of the Institute of Chartered Accountants of British Columbia and a partner in the firm of McDonald, Currie & Company, Vancouver. He is a past chairman of the Technical and Research Committee (B.C. Institute) and has taken an active part in the affairs of his Institute for several years.

NOTES AND COMMENTS

C.I.C.A. Heads to Meet

The annual spring business meeting of the Executive and Council of the Canadian Institute will take place from May 31 to June 3 at The Briars, about 50 miles north of Toronto.

Research Bulletin No. 15

Accounting Research Bulletin No. 15 on the confirmation of accounts receivable is in the last stages of preparation. It will be released by the C.I.C.A. Committee on Accounting and Auditing Research later this month, with a copy going to every member of the Institute.

Tax Brief Presented

On February 25 representatives of the C.I.C.A. Taxation Committee and the Tax Section of the Canadian Bar Association met officials of the Departments of Finance and National Revenue in Ottawa and presented to them the joint brief on amendments to the Income Tax Act.

Board of Examiners-in-Chief

The Board of Examiners-in-Chief of the Provincial Institutes of Chartered Accountants will prepare the 1958 uniform examinations at their meeting at Mont Gabriel, Quebec, from April 10 to 12.

Manitoba Institute Move

On April 1 the offices of the Manitoba Institute will be moved to the sixth floor of the Electric Railway Chambers, Winnipeg. The new premises will provide about twice the space of the former offices and will be furnished in a modern style.

Annual Conference Plans

Hon. Maurice Duplessis, Premier of the Province of Quebec, will be the guest speaker at a luncheon on Tuesday, September 16 during the C.I.C.A. 1958 annual conference in Montreal. Other announced features of the program include a civic reception and dancing at the Chalet on the top of Mount Royal and a tour of the Montreal end of the St. Lawrence Seaway, under the sponsorship of the Quebec Hydro-Electric Commission. The conference will be held at the new Queen Elizabeth Hotel.

S.I.C.A. Appointments

J. N. Allan, R.I.A. has been appointed executive vice-president of the Society of Industrial and Cost Accountants of Canada. He had served as that society's secretary-manager for the previous 12 years.

W. R. Kirk, formerly assistant director (business and industry courses) of the University of Toronto, has been named to the position of administrator of educational services. He will be responsible for the educational program under which some 4,500 students are enrolled.

D. A. Gillis becomes administrator of conferences and seminars.

Computing Conference

A Canadian Conference for Computing and Data Processing is being planned at the University of Toronto for June 9 and 10. It will present a practical report of progress and performance in the application of data

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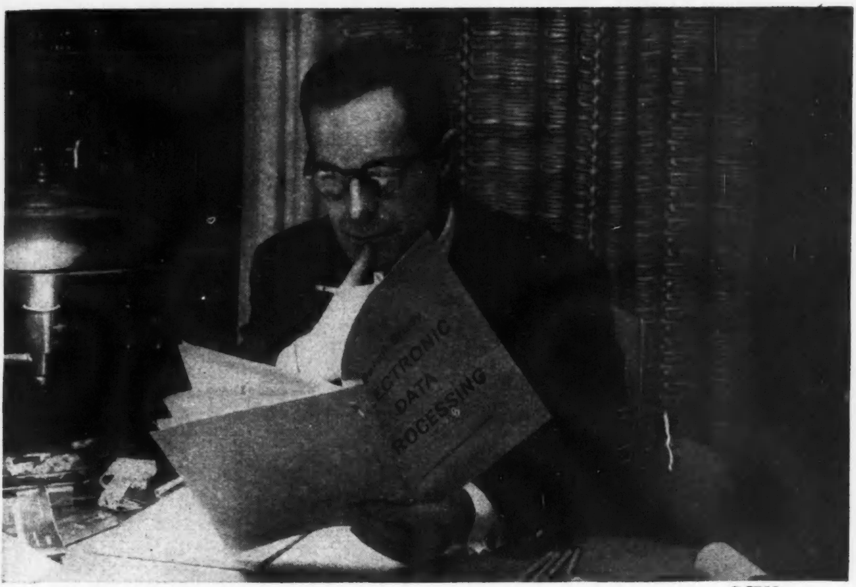

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IBM DATA PROCESSING

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processing and electronic computing methods by business, industry and government in Canada. Sponsors are the University of Toronto and a group of companies using or about to use computers. Registration forms and further information may be obtained from H. W. Rowlands, 15 Wellington Street West, Toronto.

Personnel Association of Toronto Inc.

"Personnel in Perspective" is the theme of the 16th annual conference of the Personnel Association of Toronto Inc., being held at the Royal York Hotel, Toronto, on April 17 and 18. Speakers will include Michael Starr, Minister of Labour; P. F. Drucker, Professor of Management, New York University; and Lt.-Col. L. F. Urwick, Urwick, Currie Ltd., Montreal.

In the News

JAMES C. TAYLOR, (Ont.), professor in business administration at the University of Western Ontario, has been granted a year's leave of absence to join the faculty of the Management Development Institute in Lausanne, Switzerland. Opened in the fall of 1957 under an endowment by the Nestle Alimentana Foundation, the institute is considered to be one of the most advanced business schools in the world. Professor Taylor, who will give a course on "control", is the only Canadian on the staff.

EDWIN C. HARRIS, B.Com., C.A. (N.S.), winner of the Governor-General's gold medal in 1956, has been awarded the Viscount Bennett scholarship for post-graduate study in law (1958-59), valued at $2,000. A member of the 1958 graduating class at the Dalhousie University Law School, Mr. Harris will be a candidate for the Master of Laws degree at Harvard University next year.

Gordon Commission Disbanded

The Royal Commission on Canada's Economic Prospects, headed by Walter L. Gordon, has now been disbanded after completing a voluminous final report which it turned over to government officials in January. The manuscript, forecasting the possible course of Canada's economic future during the next 25 years, is now in the hands of the printers and will be published in the near future.

The Fight Against Cancer

This month the Canadian Cancer Society is appealing for $2,484,000 to finance cancer research, cancer education and welfare services. Through our donations we can support this really extensive program. Research is our best hope against the disease.

CORRESPONDENCE

Toronto, Feb. 18, 1958

Tax Foundation Membership

Sir: You will be interested to know that the editorial and advertisement about membership in the Canadian Tax Foundation appearing in your January 1958 issue proved very successful.

We had our first response a few days after publication, and in the ensuing period have added 57 individual memberships, 39 of whom qualified for the special membership granted to students, teachers and those recently admitted to the profession. In addition there were at least another dozen requests for information about the Foundation.

I speak for the officers of the Foundation in expressing our sincere appreciation for your cooperation in this matter.

JAMES A. REID,
Treasurer,
Canadian Tax Foundation.

Toronto, Feb. 11, 1958

Cheque Endorsement

Sir: The difference between Canada and England in the law relating to cheques has for many years put Canada at a comparative disadvantage, and banking practice here has increased the disadvantage. In England the only responsibility of a bank for the endorsement of a cheque was to see that the endorsement corresponded exactly with the name of the payee; the bank was in no way concerned with the identity of the endorser or of the person who presented the cheque for payment. Compared with the Canadian arrangement, this led to less work for the bank and a greater service to customers. Protection against abuses of the system was provided through the use of crossed cheques.

England has recently increased her advantage through the Cheques Act, passed in 1957. This Act has made the endorsing of most cheques unnecessary, with an enormous reduction in office work. As far as an uncrossed cheque is concerned, this obviously makes no difference to the drawer, but it saves the drawee the necessity of endorsing the cheque (or the thief the necessity of forging the endorsement). It saves the bank the necessity of seeing that the endorsement is the same as the name of the payee. As far as a crossed cheque is concerned the same savings are effected, and as payment is always made by a credit to or a cash payment to a customer of the bank, there is no reduction in the safety of the drawer. The Act states that a paid unendorsed cheque is *prima facie* evidence of the receipt by the payee of the amount for which it is drawn, and as the Chancellor of the Exchequer said, this puts paid unendorsed cheques in the same position as paid endorsed cheques: in no other respect has the law relating to receipts been changed. *The Accountant,* in a leading article on November 23, 1957, discussed the effect of these changes on auditing procedure.

The banks in Canada continue to involve themselves and their customers in entirely wasteful work through charging "exchange" on out-of-town cheques. The Royal Commission on Banking and Currency reported in 1933: "The advantages of extending par privileges to all customers of all banks is widely recognized in other countries. It facilitates trade and, by encouraging the use of cheques, economizes the use of currency. It also eliminates the trouble and irritation involved in a multitude of minor charges". The abolition of these charges might result in loss for the banks in spite of the savings in labour, but other charges could be increased to cover it. The chief argument used in favour of these charges is that the bank loses interest — if it pays cash on a cheque which cannot be cleared immediately. Taking the banking system as a whole, this argument is nonsense; for an

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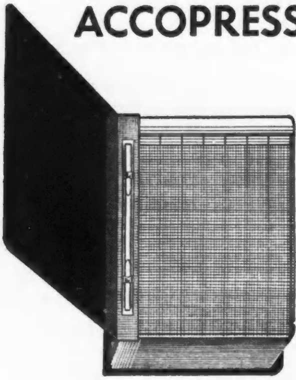
individual bank it has validity only in so far as the bank may happen to cash a greater volume of such cheques drawn on other banks than other banks cash cheques drawn on it. A very large number of cheques are drawn on the bank which cashes them, two branches of the bank being involved, and there can be no possible loss of interest. There is no way in which a bank can determine the cost of any one of its services, and no "cost of service" argument can reasonably be put forward when it involves so wasteful a procedure as that now in force.

There seems to be an opportunity for members of the accounting profession in Canada to give a lead in discussions which may result in a change in law and practice.

C. A. Ashley, F.C.A.,
University of Toronto

Note: *Correspondence with the Editor on this or any other matter is always welcome.*



Editorial

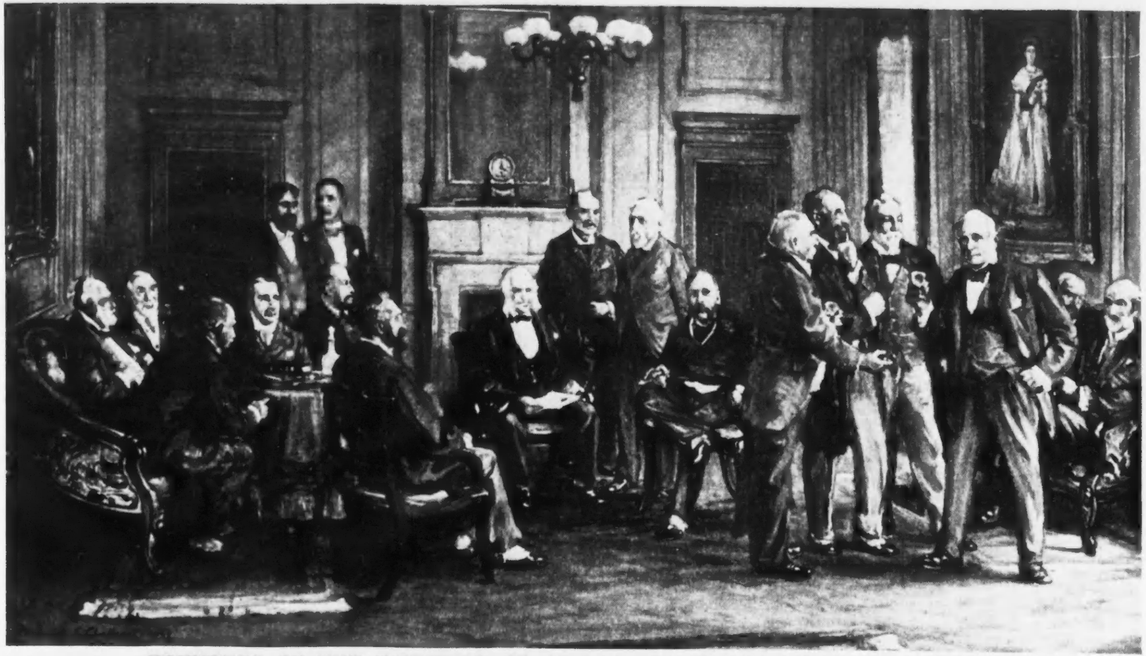
THE ACCOUNTANT'S ROLE IN ESTATE PLANNING

WITH THE INCIDENCE of taxation, estate planning has become a subject of particular interest to chartered accountants. Formerly the subject was principally the concern of lawyers because a thorough knowledge of the law of property and instruments were the main prerequisites; today other specialists, notably the accountant, trust officer and life underwriter, take part in the team of estate planning.

Not all chartered accountants in public practice think of themselves as estate planners for the simple reason that they imagine the planner must be someone who knows just about everything there is to know about income taxes, succession duties, schemes of liquidity, corporate reorganization and the variety of legal instruments of planning. Just as some men fail to appreciate that their affairs need planning and are too modest to seek advice on planning, so do some auditors steer clear of the subject because they feel that they are not qualified to deal with it from beginning to end. Here they make the mistake of overlooking their first and greatest responsibility to the client, namely to inquire whether he has made arrangements for the disposition of his estate during his lifetime and by will, and is satisfied with those arrangements.

In some cases, the lawyer will be in a position to initiate such questions, but none will deny that, in many cases, the auditor has a more intimate understanding of his client's financial affairs than anyone else. It is no criticism of the life insurance company, but may be of our profession, to admit that the life underwriter is frequently the first to make the auditor's clients aware of the need for planning.

It is up to the client to give instructions once he has been put on his guard, and the auditor need suffer no qualms if the client proceeds to involve him in an estate plan, provided he sees to it that the lawyer is consulted from the outset. The client's objectives and the size and nature of his estate will determine the need for other planners; but, regardless of the number of persons involved, the chartered accountant can feel secure in the knowledge that his client and co-planners will find him to be a worthy member of the team.



FOUNDERS OF THE INSTITUTE OF CHARTERED ACCOUNTANTS OF ONTARIO

This group portraiture of the founders of the Ontario Institute, which this year celebrates its 75th anniversary, was painted by Frederick S. Challener and hangs in the Council Chamber of the Institute. It shows the council meeting at which the founders signed the petition for incorporation. The chairman (central seated figure with white side whiskers) was Samuel B. Harman, a former mayor of Toronto. Men whose names are still associated with Toronto firms include E. R. C. Clarkson, standing at the immediate right of the chairman, and H. W. Eddis, the standing figure at the extreme right.

Reviving a Declining Business

FRANK WILLCOX

In contemplating the revival of a declining business one of two main lines of action must be decided. One is to survey the organization at random, that is, by hit-or-miss methods covering a short period of time, say in very general terms, one or two weeks. The other is to undertake a comprehensive survey calculated to cover in, say in equally general terms, four to six weeks, all the main areas in which deficiencies could be found, without purporting to deal with any features not considered to be of primary significance to the business.

In a recent successful Broadway play, a delightful little lady from Brooklyn, well equipped in the world of figures but not so well qualified in the cerebral sphere, continually asks her leading man to "make a fr' instance". Strictly without prejudice or offence but to clarify the two methods of approach, the points raised will be illustrated by "fr'-instances".

Some General Considerations

The first action is to determine the profit potential by examining the condition of the industry in which the company is engaged and its position in that industry. While it is doubtful whether such consideration will provide an immediate answer to the problem, it may well lead to the disclosure of hitherto unexpected sources of loss. The organization may not be engaged in an industry which itself is declining, but it may be occupied with outmoded elements of that industry. The passage of time and the evolution of new and better products and improved techniques may have rendered it much less consequential than in the past.

Similarly, attention should be given to the means of production at the company's disposal in the light of the location of its plant(s) with respect to access to ultimate markets, labour, raw materials, facilities for transportation, power and possibly fuel and water. These may have changed since it was erected. Moreover, the plant should be studied as to the operations now conducted in it as opposed to its original purposes, as well as to its useable floor space, layout (with particular reference to whether or not it permits of a continuous line operation), and the nature, quality, and condition of the equipment, bearing in mind the impact of maintenance. There are practical reasons for advocating that attention be given to these considerations, which may con-

veniently be classified into two groups. The first comprises those of an all-embracing nature, chief among them being the literally phenomenal growth of Canadian industry and business during the last 10 or 15 years and the incidence of a seller's market which is now drawing rapidly to a close. The second group encompasses the multitude of weaknesses and inefficiencies caused by the frailty of human nature against which business must constantly be on guard. To illustrate by way of example, in one large company operating in heavy industry in Eastern Canada, the extraction of realistic operating costs from its records resulted in finding that the annual cost of maintenance of the main type of equipment used was equivalent to 135% of its cost.

No survey, either random or comprehensive, should fail to cover the marketing activity of the business, be it small or large. It has been said that the success of a business is in direct relationship to the effectiveness of its marketing operations. In fact, in his book "The Practice of Management", Peter F. Drucker states that because it is its purpose to create a customer, any business enterprise has only two basic functions: marketing and innovation. Thus, the analyst will be concerned to verify that the plan of organization takes due account of the marketing function. He will then review briefly or examine in some detail, according to the nature of the survey, the extent to which the business seeks to engage in research, develop new products and improve those now being marketed; acquire market intelligence; stimulate a practical sense of profitability by integrating the planning of short, medium and long-term objectives, marketing expenditures and capital investments; and measure market performance.

The determination of these fundamental features of the company's organization may thus lead to a solution to the problem of why the business is dwindling, with the result that appropriate changes, possibly of a radical nature, may have to be made. On the other hand, it may be found necessary either to liquidate the business or, more likely, to reduce substantially or even extinguish a considerable part of its activities.

The "Quick" Approach

Old and tried ratios, and the interpretations drawn from them to provide information on the profitability and the efficiency of operations, are too often overlooked by companies in management reporting. Ratios concerned with liquidity; turnover of inventory; cost of sales; percentage of slow-moving and of bad accounts; and the relationship of labour, materials, overhead, and certain selected items, contained in these divisions of costs, to total manufacturing costs; and indirect to direct labour; often guide the analyst, as well as management, to significant features of the company's operations.

Other ratios, perhaps not so widely known, are also worthy of consideration, not only for the purpose of a quick analysis but also for regular reports to management and to executive management. One example is the application of quantity figures in one form or other to dollar figures, and their ratios: e.g., cost in relation to a ton of ore developed, mined and milled, or per 100 lbs. of biscuits produced, or per M foot of lumber. Other examples are: the percentage of sales that represents unprofitable

business together with the proportion of overhead that such unprofitable business absorbs; proportion of products sold in relation to the total market and the trend of that proportion; investment in machinery and equipment per production worker; percentage of capacity-operation of machinery and equipment; statistics reflecting set-up times, down times, waste and spoil product; degree of productivity per head of production employee; average size of customer accounts and relationship to the break-even point; and turnover of personnel.

Statistical methods of control as opposed to financial control — for example, the use of a force report as compared with labour dollar figures, particularly observing the rapidity with which the former can be prepared as opposed to the latter — are not usually sufficiently utilized in business. In all probability such information would have to be identified, extracted and collected by the analyst.

Experience has clearly shown that one of the major causes for declining businesses is attributable to the lack of product costs. It should be made clear immediately that this comment contains no inference whatever, expressed or implied, to a requirement for a complicated cost system. The dictum is submitted that every business organization of fair size must produce product costs in some form. These may be furnished by a fully integrated cost system but may also be provided, and serve most useful purposes, in the form of memorandum costs.

An excellent example of assessing a situation quickly by applying ratios and statistics is afforded by a large clothing manufacturing company which confined itself to reporting sales in dollars. Its sales showed a steady rise from year to year, but the management was perplexed to note that the satisfactory increase in sales was accompanied by a steady fall in profits. On analysis, it was found that the quantities sold had dropped from year to year with the result that the company was losing its share of the market. What had happened in fact was that inflationary prices had kept the dollar sales increasing.

Other techniques may also be employed to identify the cause of the decline in a business's operations. These are used by analysts and management consultants and it is unnecessary to describe all of them. For instance, one other simple but pertinent point is to study the main item of costs or sales of those companies in whose operations one element of costs or sales is significant in relation to the total.

The "Calculated" Approach

In a special survey recently completed by Dun & Bradstreet, over one million failures were analyzed from 1857 to 1957. Among the number of interesting conclusions reached was that the typical age of failing businesses was during the first two or three years of operation. Three-fifths were less than five years old while those that had been established more than ten years represented 20% of the total. The main cause of failure in large companies was a lack of managerial experience and aptitude.

While it would be convenient to be able to outline the manner in which a comprehensive survey of a company should be undertaken, this cannot be done. Each review must of necessity be conducted according to its own circumstances. However, in the majority

of cases the survey will entail a review of the company's organization, and of its plant and administrative practices, one of the most exacting types of work found in the business world and certainly in the management consulting field. Every analyst and consultant has his own way of tackling an organizational survey. His task is not one which can be segregated into parts for the attention of different persons, except as technical assistants to him. The outcome of such surveys, however, is the same in that the analyst must have acquired a good working knowledge of the company's business and its organizational structure; a fairly close understanding of its executive management, management and certain of those exercising supervisory functions; and a sound insight into that most important of all corporate motivating influences, the company's management philosophy.

A good example of the results brought about by a thorough, comprehensive and calculated survey of a company was reported in *The Controller*, July 1955. The company in question was obliged to take drastic action to revive its business from the verge of bankruptcy to which point it had dwindled steadily. The main steps that had to be taken were to eliminate two-thirds of the items carried in inventory and reduce its customers by 90%, which resulted in the freeing of some $10 millions of working capital; the vacation of a considerable acreage of good, rentable and saleable floor space; the closure of two factories and two warehouses, resulting in the addition of a further $4 millions to its net working capital; a reduction in personnel of 50%; and an increase in the inventory turnover from 3½ to 6 times annually. The final overall result was the conversion of $1 million annual operating loss to $3 millions annual profit. This is an example where the action required was drastic and courageous. It is hoped that most companies would not allow themselves to get into such a serious position before calling in assistance.

Having surveyed the company's staff and its operating and administrative practices and procedures, the analyst should be in a position to weigh the answers to many of the questions crowding his mind. Some of the more important are the atmosphere encountered throughout the organization and whether the employees have a positive or negative attitude to their activities. It is not uncommon to uncover a clearly active, or a subconsciously passive, resistance to progress when the management tends to be deficient in leadership. Perhaps the most outstanding deficiency, and the one most commonly encountered in Canadian business, is failure to develop seconds-in-command. Failure to train personnel is all too prevalent at all levels of management down to the supervisory group.

The Paramount Factor

It will doubtless be agreed that of all the many diversified phases of a company and its business, the paramount factor is man. The place of the employee in an organization, his stirring desire for creative work, and thus for job-satisfaction, recognition and achievement, is by far the most important of all corporate considerations. The introduction of more and more automation to the factory and of mechanized and electronic applications to the office result not in downgrading but in upgrading the calibre of employees, to whom more, not

less, attention must be given by management and executive management. There is a growing belief that the personnel problem in industry will have to be approached in a more direct, possibly more scientific, and probably quite different way than it is at present. To provide this employee interest and incentive there must be leadership, wise and understanding yet dynamic and inspiring, at the executive, management and supervisory levels. The analyst must constantly bear this complex and pervading subject in mind during his survey.

Often allied to the deficiency of development of personnel is lack of planning. Progressive companies bear witness to the fact that to operate a business on information based solely upon historical records and comparisons with past results is now archaic. Recently, the Stanford Research Institute studied some 400 of the largest United States corporations to determine whether growth can be planned. It found that over 60% of those corporations showing a high rate of growth reported that it had been achieved according to plan. A number of companies now project their operations over 5-year periods. One in particular, a leader in the electronics industry in the United States, forecasts over 10-year periods. Because of rapid technical obsolescence in an industry, it may not be practical for some companies to project their operations over more than two years, and one of the most advanced U.S. companies adopts this procedure. The precise period is not significant; the important fact is that most successful companies continuously reach into the future rather than think in terms of the past. The result is that there is a healthy and invigorating basic management philosophy not only at the senior levels but right through the organization to the foreman level and even below that.

Another subject to which the analyst will give attention is that of centralization and decentralization. This topic is a contentious one and finds strong proponents on each side. The point which should be grasped is that the application of either one depends entirely upon the circumstances of the organization in question, the particular business in which it is engaged and the manner in which and the object with which it conducts it. Not only that, but within an organization itself there may be need for decentralization of some aspects of the business and centralization of others.

Detailed Examination

The organizational survey having identified the areas which appear to offer a solution to the company's problems, it is then possible to direct attention to a detailed examination of the weaknesses. It should be understood that this is a completely separate assignment not to be confused with the organizational survey, the object of which has been achieved. It now falls upon the executive management to decide the manner in which a detailed study is to be undertaken of the particular aspects of the company's activities that require attention. Sometimes results are achieved quickly because, as is often said by operations research specialists, the solution to a problem is relatively simple once the problem itself has been clearly defined. But, in other instances, although the source of the weakness has been identified, the problem has not been fully defined. In such cases the solution can only be obtained by a competent analyst.

An Illustration

One case is outlined to illustrate the fluid thinking that may be required to pin-point a company's difficulty. A medium-sized organization engaged in the production and sale of machinery found itself continually priced out of the market on one of its major products. During the survey the analyst examined the costs of a number of recent tenders prepared by the chief estimator and found them to be sound and well prepared. However, it transpired that what was required to put the company on its feet was to change the management philosophy. The latter had to be made flexible enough to depart from the well-worn road which it had followed successfully for many years and to meet the present challenge, by engendering an energetic insistence on obtaining business. With this in mind, a tender by the company of a little over $1,000,000, lost to a competitor which had quoted $900,000, took on quite a different aspect. It was found that, in the ultimate, the tender could have been made for $300,000 less than the quotation of $1,000,000 by eliminating the following items:

Fixed overhead	$ 80,000
Fixed portion of development expenses	10,000
Mark-up taken on an assembly purchased from outside sources	10,000
Profit	200,000

It was recommended to and approved by executive management that future quotations be prepared according to the same formula as in the past but with one difference. The difference was that if a reduction in the amount was found necessary in order to maintain business, the comptroller would present to the president an amended estimate showing details of variable costs; the status of the fixed overhead absorption in relation to normal business; the effect that any reductions in quoted price would have on the company's position; and similar pertinent information. Thereby, the president would be placed in a position to decide the amount that could safely and properly be deducted from the quotation for the tender calculated in the normal way.

Reference has been made to the Dun & Bradstreet survey of business failures from 1857 to 1957. Another important conclusion reached from it was that accounts receivable and inventories play a large role in the failures of big concerns. The analyst will be particularly concerned during the course of his organizational survey to observe the extent of inventory control and whether it is related to production and production estimates. While it is imperative that there be good, practical controls over the organization's inventory, that production be planned and sound production control exercised and that it, in turn, take account of sales forecasts, he will also be alert to determine that there is a reasonable balance between the controls and the cost of providing them.

There can be, of course "too much of a good thing". For instance, in a fairly large organization recently surveyed it was found that some 12,000 items were carried in stock and about 7,000 issue slips were written monthly, priced and extended. A detailed examination of the inventory accounting system revealed that of these 7,000 slips, 3,200 of them reflected a total amount of only $1,600, that is, 50c a slip. It was recommended that low-value items be written-off at the time of purchase, or, in some cases, issued in bulk. A further recommendation made incidental to the survey was that a number of inventory items

be stored in certain areas in which they are utilized in order to avoid unnecessary handling costs.

To revive a declining business it is necessary to determine the cause of the decline. To arrest the decline it is necessary to eliminate the cause of it. But that is not enough. Two further and distinct steps must be taken. The first is to particularize all the circumstances which made possible the cause of the decline and thereupon make certain that everything is done to ensure that the condition, should it arise again, is prevented from taking growth. The second is, having brought the business back from a negative to a neutral position, to initiate and prosecute with vigour positive plans to urge it forward.

FROM "THE TIMES" OF 1857

THURSDAY, FEBRUARY 5, 1857.

[The Sixteen-penny Income Tax and its future]

The Income-tax is a tax which for every penny in the rate of assessment brings a million pounds sterling into the Exchequer. Sixteenpence in the pound yields just sixteen millions in clean hard money, with no great expense in collection and with a greater certainty, precision, and completeness than is the case with any other impost which the genius of financiers has been able to devise. But this is not all that the Income-tax raises. It raises half-a-dozen constant, keen and interminable conflicts of principle, keeps large classes of the people in a state of chronic discontent, and at every period offering a chance of relief throws the whole island into profound agitation. It is a tax which everybody is fain to use, but nobody is ready to justify, which does our work for us while we murmur at it, which was never quite sanctioned and yet could never be quite dropped, so that in the end, as Mr. Gladstone expressed it, we went on living with it from year to year, like children regardless of the future, and content with providing for the present.

Such being the Income-tax, what are we to do with it? Proscribe it utterly – name, substance, and all? That would be to destroy the most formidable weapon in the armoury of the State. . . . Shall we make it permanent? That would be to make injustice, impolicy, and discontent permanent – to attach a character of durability to measures only tolerated upon the express assumption of their being transitory. . . . What shall we do with it, then? What its very nature and character suggests – keep it for times and seasons as exceptional and anomalous as itself . . . in other words, for the needs of war. . . .

Brokers' Records

W. GRANT ROSS

THE STOCK BROKERAGE business in Canada is subject to supervision and regulation under the Securities Acts of the various provinces. Under these statutes much authority for the supervision of members is delegated to the governing bodies of the Investment Dealers Association, the Broker Dealers Association or the various stock exchanges. Nearly all stock brokers are members of one or more of these groups. In devising a system for a broker a careful review of the applicable regulations should be made in order to determine that suitable accounting records are maintained. These records should be such that statements and reports can be prepared from which the governing body can ensure that the member is abiding by the rules of the exchange or association.

As a stock broker deals in cash and securities, both of which are subject to misappropriation, the accounting system should contain an adequate system of internal control; as the business is subject to extreme fluctuations in volume of transactions the accounting system should be flexible to permit expansion; and as the value of securities may fluctuate from day to day or minute to minute the system should be able to provide up-to-the-minute information.

The accounting system of a stock broker follows standard principles of accounting and many bookkeeping records similar to those used in other businesses are maintained. However, due to the specialized nature of the business, additional records have been developed. The need for specialized records is apparent when consideration is given to:

1. The duties of a stock broker. He may—
   (a) buy and sell securities on behalf of his client, other brokers or himself,
   (b) hold securities in safekeeping pending further instructions from his client,
   (c) hold his client's securities as collateral for a margin account,
   (d) collect dividends for his client,
   (e) supply information to his client about various securities.
2. His sources of revenue. These include—
   (a) commissions as an agent,
   (b) interest charged to clients on margin accounts,
   (c) profits or losses as a principal from trading in securities,

(d) profits from underwriting security issues,
(e) dividends and interest on securities owned.

3. The audit regulations of the various exchanges and brokers associations.
4. The necessity for recording the security transaction as well as the dollar value.

Only records peculiar to stock brokers will be outlined in this article; and to avoid lengthy descriptions a glossary of terms is provided in the appendix.

Purchase and Sale Records

Once the salesman has received instructions from his client, a buy or sell order is prepared and turned over to the broker's office for execution by the firm's trader. After the transaction has been completed the trader contacts the office and gives the details of the trade. The order form is completed by the contract department showing name of the client, security, number of shares, price, other broker and amount of the transaction. The amount of commission charged by the broker and tax, where applicable, are then inserted and the order forwarded to the contract department to prepare a contract.

The contract is usually prepared in multiple form and, in many cases, the record of purchases and sales (blotter) is prepared simultaneously. The contract usually shows the name of the broker from whom purchased and to whom sold, date of the transaction, settlement or value date, the number of shares, security name, price, amount of the transaction, commission, tax if applicable, net amount and the name of the client.

The various copies of the contract are usually handled as follows:

1. The first copy or original goes to the client.
2. The second copy is forwarded to the clients ledger department for posting to the client's account.
3. The third copy is first used to post to the margin ledger; it is then forwarded to the stock position clerk for posting to the stock position book. An alternative procedure sometimes used is to send the second copy to the stock position clerk for posting to the stock position book at which time the stock position of the client is noted on this copy. It is then forwarded to the clients ledger department for posting. The information noted by the stock position clerk is checked by the clients ledger clerk.
4. The fourth copy is forwarded to the cage where it is filed alphabetically by security and is the authority for the cage to deliver securities or the advice to the cage of securities to be received.
5. An extra copy of the contract is prepared for unlisted transactions. This copy is forwarded to the other broker concerned in the transaction in the case of non-members, or to the clearing house in the case of members.

Four blotters are maintained — for purchases and sales of listed and unlisted security transactions. Where the unlisted transactions are infrequent, hand-written blotters are commonly used. The blotters are totalled and posted daily or monthly to the general ledger.

Cage Records

The cage is responsible for the physical handling of all securities in-

cluding delivering to and receiving from brokers, the clearing house and clients. This requires the cage to keep a record of all receipts and deliveries of securities, including those sent out for transfer or pledged as collateral to call loans.

When the client delivers a security, either to be sold or which has been sold, a receiving slip is completed. The security is filed alphabetically in a safety deposit box in the cage. Then:

1. If the security has been sold through the stock exchange on receipt of the clearing sheet the security is forwarded to the other broker via the clearing house, or
2. If the security has been sold to another broker other than through the stock exchange a delivery slip is prepared and the security is forwarded to the other broker, or
3. If the security has been sold to another client (i.e. in the case of crosses) a delivery slip is prepared and the security is forwarded to the client for whose account it was purchased.

For securities purchased for a client, on receipt from the selling broker or clearing house, the security is filed alphabetically in a safety deposit box in the cage. For a cash account, a delivery slip is prepared and the security is forwarded to the client on payment or is placed in safekeeping for him; for a margin account, the security is retained in the cage or is delivered to the firm's banker as security for its call loan.

Delivery and receiving slips are usually prepared in triplicate showing the date, delivered to or received from, number of shares, certificate numbers, name of security and name of registered owner. The original is forwarded to the client. One copy is forwarded to the margin department if necessary, and then to the clients ledger department. The second copy is passed to the stock position department.

A blotter is required to provide a method of tracing security transactions. This blotter may be divided into three sections – securities delivered, securities received and securities being transferred. The blotter is usually prepared at the same time as the delivery or receiving slips and lists the same information.

The cage maintains a record of all securities pledged as collateral to call loans. This record is either in the form of copies of the delivery slips filed alphabetically by security under each loan or an alphabetical listing of the securities pledged to each call loan. When a security is withdrawn from the collateral securing a call loan a copy of the receiving slip is stapled to the original delivery slip. Each month the bank or person making a call loan confirms the securities held as collateral, and this information is checked to the records in the cage.

The cage maintains control of securities in transfer by retaining a copy of the list of securities sent to the transfer agent via the clearing house, a copy of any delivery slips for items delivered directly to the transfer agent and a copy of the letter of transmittal to out of town transfer agents. When securities are received back, the listings are marked off, and any items not returned are followed up.

Securities held in the cage are usually counted at least once monthly and balanced to the stock position book. Because of the value and quan-

tity of negotiable securities handled, it cannot be overemphasized that:

1. The cage should be adequately and competently staffed.
2. Entry to the cage should be restricted to authorized personnel.
3. A strict control should be maintained over security handling.
4. All transactions should be readily traceable.

Clients Ledger

Each transaction in a client's account has two phases:

1. Recording the dollar balance.
2. Recording the security position.

For this reason a client's account is designed to show both security transactions and dollar balances. The ledger card shows date, number of shares bought or sold, security name or particulars of the transaction, price, debit, credit and balance. In addition, the client's security position may be shown on the same card in a number of vertical columns (stock position columns) to the right hand side of the money balance column, a separate column being devoted to each security or a separate position card may be maintained for each client.

The purchase or sale of the security is posted from the second copy of the contract on the settlement date. The interval between the date of the transaction and the settlement date is used to permit contracts to be prepared and delivered and to allow for the physical transfer of the securities. Receipt and delivery of securities is posted from the second copy of the receiving or delivery slip, and the adjusted number of shares is entered in the stock position columns.

Other entries that appear in a client's account are –

1. Cheques issued – posted from a cheque copy.
2. Cash received—posted from a receipt copy.
3. Adjustments—posted from a journal entry.
4. Interest charged and allowed – in some cases this is posted from a listing of interest charges. In most cases, however, the interest chargeable on an account is calculated, noted on the clients ledger, and re-checked. It is then entered as a posting to the individual account and then with other interest charges totalled and posted to the general ledger.

Clients' statements and ledger cards are prepared simultaneously. However, the statement does not show the details of the stock position as shown on the right hand side of the ledger card. The client's stock position is summarized at the bottom of the statement at the end of the month. The client's statement is usually checked against the stock position book before mailing.

The clients ledger is a combination of accounts receivable and accounts payable. A debit money balance represents an amount receivable from the client and a stock position (long) of the client represents the liability of the broker to the client for securities owing to the client.

On the other hand a credit money balance represents an amount due to the client and the stock position (short) represents the security owed to the broker by the client.

The ledger may contain debit or credit money balances when there is no stock position, a debit balance being an unsecured account and a credit balance being a "free credit" or a deposit by the client.

Client broker accounts are handled in a subsidiary ledger in the same

manner as other clients, except that the client broker is charged a reduced commission.

The handling of the firm's own transactions differs very little from a normal transaction. Firm accounts arise through:

1. Purchase and sale of securities for the firm's own account.
2. Underwritings made by the firm.
3. Errors made by the staff in buying and selling securities.

Margin Records

Some brokers offer their clients the privilege of buying securities on margin. The client pays only part of the purchase price, and the broker holds the stock as security for the unpaid balance. Margin is allowed at the discretion of the broker, but various exchanges limit the type of stock that can be accepted for margin purposes and the percentage of margin required. The broker must adhere to the regulation of the exchange to which he belongs, but some brokers impose additional restrictions, and others do not permit any margin accounts.

The margin department usually has in its possession an agreement signed by the client permitting the broker to pledge the securities held on margin as collateral to a loan, to sell the securities to meet margin requirements, and to charge interest on the account. The agreement card may show the client's name, address, specimen signature and other information and be filed with the margin ledger card or separately.

The margin ledger card differs from the clients ledger account in the following respects:

1. The margin ledger is a memorandum record only and is posted on the transaction date, whereas the clients ledger account is posted on the settlement date. Posting the margin accounts on this basis provides an up-to-the minute record of the account.
2. The record is usually maintained by erasing the existing figures and inserting current figures.

The margin ledger card usually shows number of shares held, name of security, market price, market value, loan value, total loan value, ledger balance, name and address of the client, and the salesman.

The loan value depends upon the market value of the security and for this reason margin accounts must continuously be reviewed. The broker must know as soon as a client becomes under-margined. This situation arises because of a decline in the market value of the security, or an increase in the client's debit balance. When a client's account becomes under-margined a broker can take appropriate action, i.e. obtain further security, obtain further payment on the account, or sell the customer's security and credit the proceeds to the customer's account.

As margin records must be kept up to date, all cash receipts and disbursements, adjustments, interest charges, receipts and delivery of securities and purchase and sale contracts must be recorded promptly.

Safekeeping Records

One of the services commonly supplied by a broker is the safekeeping of a client's securities. As these securities are owned by the client, they must be physically segregated and earmarked for the client, and the broker is not allowed to use them for any purpose without the written approval of the client. Because of this,

many brokers remove the safekeeping securities from their stock position book and record them separately. Most exchanges require securities on which no money balance is owing to be placed in safekeeping and held available for delivery to the client.

The safekeeping ledger records the securities alphabetically with a separate sheet for each security. The ledger sheet shows the date received, name of client, number of shares, certificate numbers, delivered to and date delivered. Some brokers maintain a separate listing showing the securities held for each client. The securities are filed either in security order or by client and are usually kept in a separate safety deposit box.

Stock Position Records

Because of the negotiable form and value of securities handled by a stockbroker, it is necessary to know at all times the location of the securities. A stock position book is maintained for this purpose.

In the stock position book (sometimes the book is replaced by ledger cards) the securities are recorded alphabetically, with a separate page for each security. Each page shows the client's name on the left hand side and the rest of the page consists of numerous vertical columns, with a separate column being used for each day. Postings are summarized before being entered. The detail of the transaction is not entered, but the revised position only is entered in the appropriate column. Short positions are circled or entered in red. The net balance of all long and short positions in any security should equal the total of the shares under the control of the broker (i.e. in the safety deposit box, on loan or in transfer). In order to balance the security position, the location of securities is usually noted at the foot of each page. Frequent counts should be made to check the accuracy of the stock position book and to verify the existence of the securities which the records indicate should be on hand.

The stock position records have additional uses. If there is a sudden drop in the market value of any security the broker can determine from the stock position book the name of all clients for whom shares are held so that margin requirements can be rechecked. The dividend lists are also prepared from this record in order to allocate dividends received to the proper client.

Dividend Records

Another duty of a broker is to collect and credit to his client's account all dividends declared on securities held by him for his client. Dividend payments are made by the paying corporation to the person in whose name the shares are registered on the record date. This person is not necessarily the beneficial owner of the shares. It is necessary for the broker to claim on behalf of his clients the dividends paid on all shares under his control on the record date which are neither registered in his name nor in his clients' names. The broker then credits these dividends to the rightful owners.

A separate sheet is normally prepared for each dividend declared. These sheets form a subsidiary dividend ledger and are controlled by a separate general ledger account.

A list is prepared of the number of shares owed to or due from each client and broker as of the close of business on the day prior to the ex-dividend date. This list is compared with the registered owners as shown

on the shares held in the broker's safety deposit box, pledged with the bank, in safekeeping, or in transfer. For those clients for whom the broker is holding securities which are not registered in the client's name, the amount of the dividend will be credited to his account in the client's ledger and debited to the dividend ledger.

If a shareholder is not the beneficial owner a claim must be made on him for the dividend which he will receive. This claim is usually not entered in the books of account until the dividend is received. It is then credited to the dividend ledger, together with dividends received on shares registered in the broker's name. Dividend claims between member brokers are sometimes handled through the clearing house of the exchange.

In order to facilitate the collection of dividends, a broker normally has shares which he has under his control registered in his own name (except shares held in safekeeping), and such registration may continue after the securities have been delivered to complete a transaction. Because of this, dividends received by him on shares registered in his name added to those collected from other brokers or individuals may exceed the total due to clients and himself. The credit balance remaining in the dividend ledger is reduced by claims made on him by others. The resulting balance is shown as a current liability until it is transferred to the broker's profit and loss or capital account. The Income Tax Act requires that brokers withhold tax of 15% on dividends held for more than one year where the ownership is unknown. This is deducted from the payment if a claim for such dividends is made on the broker.

Particular care should be given to the internal control maintained over the receipt and disbursement of dividends by the broker, as this is a vulnerable area for defalcations.

Clearing Department

A stock exchange operates a clearing house for the convenience of its members in order to minimize the number of stock certificate deliveries required from member brokers, and to facilitate the cash settlement between members. Each exchange clearing house has its own regulations covering the basis of settlement, form of clearing sheets, time of clearing, time of delivery, treatment of securities a broker is unable to deliver, etc.

The broker's clearing department controls the movement of securities to and from the clearing house and to and from non-member brokers and makes settlement with them. The clearing department is usually combined with the cage.

Other Departments

1. *Statistical and research*

   Information of interest to the broker or his clients is gathered on public corporations. A statistician reviews this information, summarizes important data for the clients, and may prepare special articles or bulletins on the corporation.

2. *Order*

   The order department receives orders from the salesmen and transmits them to the firm's traders at the exchange. The traders notify this department on completion of the transaction and the information is passed on to the contract department. Unfilled orders

are maintained in the order department and lists are prepared and supplied to the firm's traders.

3. *Accounting*

The usual records found in most other companies are found in a broker's office. Such records include cash receipts and disbursements books, journals, payrolls, commission records, and a general ledger.

In addition to the special records described in this article it is customary for a broker to maintain a call loan ledger in which details of the securities pledged against each loan are shown.

Financial Statements

The balance sheet presentation of several items is a consequence of the specialized nature of the broker's business. Accounts receivable and payable are subdivided into clients, partners and brokers. Clients and partners balances are further classified as to whether they are fully margined, undermargined, partly secured, unsecured or cash settlement accounts. Brokers' accounts are classified between members and non-members and according to whether the transaction has been cleared subsequently.

The financial statements required by some exchanges and associations are designed to show whether or not the broker has sufficient capital to make up the deficits in any unsecured accounts and whether or not he has sufficient capital to provide margin on undermargined accounts and on the firm's own holdings, and to finance the volume of business which he is conducting.

APPENDIX TO BROKERS' RECORDS

Blotter — a listing of transactions in journal form, e.g. purchases and sales, receipts and deliveries.

Cage — the section of the office that handles the receipt and delivery of securities.

Call loans — a loan made to a broker by a financial institution for which securities are pledged as collateral.

Cash account — an account where the customer is paid for the security sold or pays for a security purchased at the time of or shortly after the settlement date.

Client broker — a broker, not a member of an exchange, who deals through a member acting as his agent.

Clients ledger — the accounts receivable (or customers) ledger in which is recorded both dollar and security transactions.

Crosses — the matching by a broker (after execution of the transaction on the exchange) of an order to sell by one client with an order to buy from another client without involving the clearing house in the physical handling of the security.

Fully margined account — an account that meets the exchange margin requirements.

Listed transaction — a trade in a security listed on an exchange.

Margin — the excess required by the regulations of an exchange between the market value of the securities acceptable for margin purposes which are held as collateral and the balance of the client's account.

Margin ledger card — the memorandum record in which is recorded the outstanding ledger balance in the client's account and the loan value of securities pledged as collateral.

APPENDIX TO BROKERS' RECORDS (Cont'd)

Member — member of an exchange.

Non-member — non-member of an exchange.

Over-the-counter transaction — a transaction by a broker with non-member of an exchange, or with a member for items which are not cleared through the exchange clearing system.

Partly-secured account — an account for which the collateral securities have a market value less than the amount of the account.

Settlement or value date — the date upon which settlement of the transaction is to be completed by the payment of money or delivery of securities. This is usually the third day following the trade date.

Stock position — the condition of a broker's or client's security holdings, i.e. long — is owned; short — owes.

Stock position book — the record in which is recorded the location of all securities for which the broker is responsible.

Trade date — the date of a transaction to buy or sell securities.

Transfer agent — the representative of a company that records transfers between registered shareholders.

Under-margined account — an account that is fully secured by the market value of collateral securities but does not reach the margin requirements of the exchange.

Underwriting — the purchase by a broker or group of brokers of an issue of securities that are to be sold to the public.

Unlisted transaction — trade in a security not listed on an exchange.

Unsecured account — an account for which no security is held.

IDEAL LEADER BEHAVIOUR

There seem to be stereotypes of ideal leader behaviour in organizational settings as perceived by group or staff members. The dimensions suggest that the ideal leader is one who places few demands upon the persons he leads, who does not interfere with their freedom, and who is a group member and "one of the boys". However, at the same time, he is perceived as ideally not a part of the group, as one who can do things for the group that the group cannot do, and as one who gets things done. There seems to be a basic conflict in our idealogies of leaders. We want persons in leadership roles, and yet we do not want to place limitations upon ourselves to submit to leadership.

When a given administrator describes himself as a leader, this self-description is nearer to the subordinates' description of the *ideal* leader than it is to the description of him by his staff. In other words, the subordinates percieve him less in terms of their ideas than he perceives himself in terms of their ideal.

—Carroll L. Shartle, "Executive Performance and Leadership", published by Prentice-Hall Inc., New York, 1956; p. 119

The Floating Charge - Cinderella Security

WINSLOW BENSON

THE FLOATING CHARGE, one of the forms available under our law for securing corporation debt, is the Cinderella of Canadian corporation finance. Long accorded a minor role, a mere servant to her older sister the specific mortgage, she sat unappreciated in the chimney corner. In recent years, however, she has appeared with increasing frequency in a more important role, that of sole security for corporate obligations. This new prominence has so attracted the favourable attention of borrowers and lenders that a fairly-tale ending is predictable.

Her sisters still dominate the scene: first mortgage bonds and unsecured debentures continue to be the main instruments for corporate borrowing. Indeed her recent role has not yet won a distinctive title. "Debenture" is used on the street to describe the obligation secured only by floating charge as well as the unsecured obligation.

Throughout this article the obligation secured by floating charge will be designated "secured debenture". This is a title which might well be generally adopted. It would distinguish clearly on the one hand the "first mortgage bond" which must be secured by a specific mortgage on land and plant and, on the other, the "debenture", a bare promise to pay unsupported by any security.

The increasing use of the secured debenture has been in the role of an intermediate grade of obligation. Investors accept the unsecured debentures of a "triple A" borrower. But many sound public enterprises which do not merit such exalted rating deserve nevertheless to be relieved of the burdens of a specific mortgage. Security in the form of a floating charge was offered by way of upgrading their bare obligation. The growing prominence of this financing method has resulted in a wider recognition of the floating charge as a unique and valuable form of security.

Now that the secured debenture has become increasingly familiar and acceptable to both borrower and investor there are reasons why it may well come to replace the unsecured debenture in Canadian finance. The modern unsecured debenture, issued under a trusteed indenture, was evolved in the United States. The object was to relieve high-grade borrowers from the disadvantages of the specific mortgage. Since these disadvantages are substantial, the objective was a sound precedent for Canadian finance. The solution adopted

– the introduction of unsecured obligations – had less logic in its application in Canada.

The same objective can be achieved here through a floating charge security which also avoids all the disadvantages inherent in the specific mortgage. This alternative was not available to Wall Street because the floating charge is not a security recognized in the legislation of the States of the Union. The only method there was to forego security completely.

Advantages of Secured Debentures

The secured debenture provides all the advantages of the unsecured obligation *plus* important security. If trouble comes, it gives the lender priority over all unsecured debt against all the assets of the company. This is an advantage which can be exploited in corporation finance. The holder of an unsecured debenture is an ordinary creditor. It should be possible to market obligations secured by a floating charge more favourably than unsecured debt.

An advantage more important than priority is the remedy afforded by a floating charge security. If a company's funded debt is unsecured, bankruptcy may be unavoidable if default occurs. The continuance of business operations under our Bankruptcy Act would present great difficulties. That legislation is designed ideally for small commercial enterprise, such as the local retail shop. It is liquidation legislation and is unsuitable for the operation of a large industrial enterprise pending reorganization. "Winding up" Acts are subject to the same objection. It is frequently overlooked that the situation is quite different in the United States where Chapter X of the federal Bankruptcy Act is a reorganization statute with adequate machinery for this special purpose.

Protection by Reorganization

Protection of the debenture holder's investment after default lies in reorganization, not liquidation. Reorganization is a lengthy process and some method of carrying on and financing the company's operation in the interim is essential. A floating charge affords the creditor the remedy of having a receiver and manager appointed to carry on the undertaking as a going concern and preserve the goodwill. Additional working capital can be raised by way of receiver's certificates, and a simple and effective method of carrying on the enterprise under the court's direction has been evolved over more than half a century. From this experience we inherit tried practical techniques and a rich store of legal precedent. Canadian reorganization legislation contemplates the use of this remedy and this procedure. They are complementary.

These benefits do not enure solely to the lender. No one is more interested in the preservation of an enterprise in financial difficulty than the owners of the equity. Most receiverships come about at the request of the company because of lack of working capital. The company itself desires receivership to enable rehabilitation and so preserve an equity value. The logical course for a company contemplating public borrowing is to *insist* that a floating charge should secure its debentures.

Appropriate to Canadian Finance

The unsecured debenture came to us because of the inevitable tendency of Canadian corporation finance to

follow the lead of Wall Street. The influence of United States practice on investor and borrower increased with the growth of American participation in Canadian financing and of American ownership and management in Canadian enterprise. The Canadian company which earned high-grade rating insisted that it should borrow without security like its American counterpart. Hence the professional groups who shape Canadian investment methods — the investment dealers, lawyers, and financial specialists — have often been forced to swim with the tide.

These Canadian finance professionals have persisted, nevertheless, in extolling the virtues of floating charge security; Canadian underwriters have utilized the secured debenture most effectively whenever opportunity offered. The status it has now achieved and the increasing recognization of its unique virtues should eventually lead to the disappearance of the unsecured debenture from the Canadian market.

It is necessary here to make a reservation. Throughout this article the value and effect of a floating charge is dealt with in the context of its operation in the common law provinces. Real property in the Province of Quebec may sometimes constitute a significant item among the assets of a company which desires to issue secured debentures. In such cases additional measures would be necessary to make the security (the priority) effective as against third parties in Quebec. On the other hand it seems unlikely, for a number of reasons, that companies whose undertakings are confined to Quebec will make use of secured debentures. Perhaps some day the receivership process may be introduced in that province by legislation as was once attempted.

While it seems certain that the floating charge has a promising future in the financing of "triple A" companies who now borrow without security, there is yet another avenue which may lead our Cinderella to her prince. There are many sound enterprises which, for a variety of reasons, cannot borrow on their unsecured obligation. There are also "triple A" companies who offer security in order to obtain funds at minimum cost. Until recently the only security acceptable to Canadian investors has been the specific mortgage. Here again the Wall Street pattern has set the style; the specific mortgage is the only form of security available to United States finance.

Canadian underwriters, corporation lawyers and experts in our financial institutions have a lively appreciation of the merits of the floating charge as security. But custom is the compelling factor in investment practice. Underwriter and borrower must be completely confident that the market will accept the type of obligation offered. Progress in changing an established pattern is inevitably slow.

"Bricks and Mortar" Security

The increasing prominence of the secured debenture may bring about a change in this area of corporation finance also. It appears that there is today a wider investor acceptance of two principles. First, real security lies in earning potential, not in bricks and mortar. Secondly, the floating charge does not lack merit in the bricks and mortar aspect of security. This second proposition is worth examining.

The security structure of every first mortgage issue includes a floating charge on assets other than fixed plant. It constitutes an ideal form of

security on personal or chattel property of a company – inventory, receivables, etc. – which constantly fluctuate. It leaves the company free to deal with such property in the ordinary course of business, to use, sell, replace, or give bank security in the normal operation of the undertaking. Upon enforcement or bankruptcy, however, the charge ceases to "float" and crystallizes as a fixed charge. The holder has a lien on all such property then owned which takes priority over claims of ordinary creditors.

Perhaps it is because of this familiar use as a charge on chattel property that the investor has not considered the floating charge an appropriate form of security on real estate or fixed plant. This would be a naive distinction to make today. Such thinking fails to distinguish corporation finance from real estate investment. It is appropriate to the day of the small family enterprise. With the growth of corporate enterprise the floating charge was evolved under British law as a form of security precisely adapted to corporation borrowing. Why should not a company be permitted to deal with its real property, like its other property, in the ordinary course of business? Why should it not be free to dispose of portions of its real property no longer required for or suitable to its operations, if such disposal will benefit the enterprise? The proceeds realized will go into other property, real or personal, which will in turn become subject to the charge. So runs the argument for the floating charge.

The only restriction on this right to deal with real property in the ordinary course of business, which the investor would feel essential, is to prevent the mortgaging of such property to secure debt in priority to the debentures. Hence it is normal practice to prohibit this by the provisions of floating charge indentures, the standard "negative pledge" covenant. Many additional covenants have been developed for the protection of the lender, and he may even require a covenant not to sell designated plants and properties.

A Versatile Instrument

Investors to whom security has meant a mortgage registered against property titles do not find it easy to rely on covenants, on "mere promises". But the secured debenture is a versatile instrument, and the holder is not forced to rely on the good faith of the borrower to perform its covenants. Descriptions of real estate may be included in the indenture under which the debentures are issued; the indenture may be registered against the titles; the property cannot be dealt with contrary to the restrictive covenants. This practice has been followed in many offerings. The lender obtains a guarantee against fraud as effective as a specific mortgage. Yet the borrower avoids the main disadvantages of mortgaging. The expense of registration is trivial compared with the burdens of mortgage security: the delays attendant on certifying titles, the elaborate ritual of release and insurance provisions.

The guarantee afforded by this practice of registration has been an important factor in gaining acceptance of the secured debenture as a substitute for the first mortgage bond. With increasing use there will be a greater readiness to forego registration in appropriate cases and rely on the borrower to observe its covenants. Only by a deliberate breach of contractual obligations can the priority of the secured debenture be defeated.

Is this a real risk in lending to a large public company, a stable organization which has well-known directors and executives, responsible auditors and published annual statements? Fraud under corporate organization involves conspiracy and collusion. Where the investor is seriously concerned about the possibility of fraud on the part of a company borrower, he will not lend to it on any security. Corporation finance is founded on confidence in the good faith of management.

Even without registration the value of negative covenants does not rest entirely on the company's good faith. The floating charge priority is valid against any purchaser or mortgagee who has notice of the covenants or who is party to the fraud. Performance of the covenants is "policed" by the trustees of the indenture and by the auditors of the company. The covenant is more than a promise.

One concern frequently expressed about floating charge security is the fact that a creditor who obtained judgment and execution could secure priority. This is not a practical danger. The company itself, management and shareholders, would have a vital interest in precipitating receivership to defeat any such action, and the company would cooperate with the trustee to this end.

Substitute for Mortgage Bonds

These, then, are some of the reasons why many investment experts consider that a well designed floating charge security is not inferior to a specific mortgage as security for the obligations of large public corporations. A claim that it is superior may well be made where the special nature of the enterprise makes a floating charge more appropriate. This applies with particular force in the oil and gas industry. Most companies engaged in production own many property interests which are the subject of exploration and development. The "farming out" of leases, the continual shifting of participations – "wheeling and dealing", to use a familiar term of the industry – is typical of and essential to their operations. A specific mortgage security seems ill-devised for financing such an undertaking. Another example is the enterprise which owns a chain of service and sale outlets.

Is it possible to justify the elaborate and costly apparatus of mortgage security for such a borrower as the typical pipe line enterprise? Management is well known and its responsibility assured. The property consists of the company's interest in numberless small parcels of land touched by the line in its long march across a province or a continent. If a floating charge only is taken, can it be seriously suggested that there is a risk of the security being defeated by a breach of the company's covenant not to mortgage or alienate any of this property? Surely we arrive, in this case, at a *reductio ad absurdum.*

It seems likely, therefore, that the secured debenture will be increasingly employed as a substitute for the first mortgage bond, to the extent that legislation does not interfere with the free decision of investors. This is a significant qualification. Canadian legislation which controls insurance company investment determines the form of security in an important portion of corporation borrowing. It constitutes, also, a conservative influence on investment thinking. It provides that, unless the borrower can meet a test based on dividends or

earnings over a five year period, its obligations must be "fully (*sic*) secured" by a mortgage on real estate. There can be little complaint of this requirement except in its application to newly incorporated companies. Since the earnings tests are inapplicable to them, mortgage security is arbitrarily required for all borrowing by new enterprises however strong, whatever their individual merit, whatever the nature of their undertaking.

Need to Amend Legislation

This raises some obvious questions. If it is important to relieve meritorious borrowers from the burden of the specific mortgage and if the well designed floating charge security is not inferior in most cases and more appropriate in some, should all new enterprises be arbitrarily denied borrowing by secured debenture? Should modern investment legislation exclude (as it does in effect if not by words) such an important form of security as the floating charge? If the legislation were amended to accord equal recognition to the secured debenture, all companies regardless of their earnings record would be permitted to borrow by secured debenture. But is this a serious objection on the premises discussed above?

Indeed there is no logic in the objection that such an amendment would permit insecure investment in doubtful enterprises. So does the existing legislation. A mortgage on real estate is in itself no guarantee of a sound investment. Analysis of earning potential, appraisal of management in respect of ability, enterprise and integrity and many broad economic tests related to the industry and the particular enterprise are essential. The investment departments of institutional investors are well equipped to make this kind of discriminating selection. No one suggests that statutory controls eliminate the need for prudence.

One thing seems reasonably clear in view of the growing acceptance of the secured debenture — if the legislation were amended, Cinderella would assuredly don glass slippers and go to the ball.

A DEDICATION

American writer Earl Wilson recently dedicated a book "to one who by repeated urgings drove me on, shared with me for richer or for poorer, and to whom I shall always, so long as I live, owe a great deal — the income tax collector."

— *Taxes*, February 1958.

Controlling Costs in Industrial Catering

STANLEY R. SMITH

In recent years management has more than ever recognized the need for adequate catering services for its employees. Good "in plant" eating facilities foster better employee relations and in turn result in a more satisfied and efficient staff.

The prime requisites in industrial catering that will meet the demands of both employers and employees are (1) well prepared food (2) fast service and (3) attractive prices. Experience has proven that these requirements can best be met by firms specializing in catering services rather than by industrial companies attempting to operate their own departments for this purpose. Management's recognition of these facts and the growth of industry in Canada have sown the seed for the birth of numerous companies offering industrial catering services.

The accountant's interest in this type of operation stems from the demand for attractive prices. If the caterer is to win the "battle with the lunch-box", which must be done to make the operation a success financially, prices must be kept at a minimum. Where price is such an important factor it naturally follows that controlling of costs is also important. Accountants know that one of the most effective tools for controlling costs is an accounting system which will quickly and reliably disclose excessive or unnecessary costs. Certainly all businesses require that a watchful eye be kept on costs. However, in the business of industrial catering this scrutiny must also cover such points as excessive production which results in high wastage, effective use of reclaimed ingredients to minimize wastage costs, planning of menus to take advantage of "in season" commodities and variance from recipes which might seriously alter material costs.

A Look at the Operation

With the need for effective accounting control established, it might be well to look at such an operation before suggestions to afford this control are offered.

In the majority of larger industrial plants one of two general types of catering will be found. The first is the cafeteria and the second, a method of delivering the meal to the employees at their place of work or at certain designated areas in the plant. The latter is becoming more widespread in its application in that

it minimizes the need for dining room facilities and a smaller portion of the employees' lunch period is lost in travelling to and from the dining area. Where the firm is not too large, the food for this type of catering can be prepared in the caterer's own kitchens which obviates the need for kitchen facilities in the plant. In either type of catering, the staff employed, in addition to administrative staff, can be divided into two categories: kitchen and serving. The kitchen staff is comparable to the factory staff in a manufacturing concern, with the preparation of food being regarded as direct labour and cleaning, dish-washing and the like being regarded as indirect labour. Depending on the size of the operation, some employees may do both kitchen and serving duties. In such cases, the payroll distribution should show the allocation of time and cost between these classifications. Where practicable the kitchen direct labour should be further subdivided into such classifications as bake shop, salad-making, sandwiches, hot-plates, etc.

Many of the ingredients used in this type of operation deteriorate rapidly and are therefore often purchased only as required. This type of purchasing facilitates the costing of materials used as in many cases the total of a supplier's invoice can be applied directly to a specific cost sheet.

The expenses can be divided into three main categories: kitchen expenses, serving or distribution expenses and administrative expenses. Kitchen expenses are comparable to factory expenses in a manufacturing concern and should therefore be regarded as the third element in the cost of production.

Development of the System

The foregoing does not paint a fully comprehensive picture of a commercial catering operation but should suffice to indicate to the accountant the general set of accounts required and the types of transactions to be recorded. The purpose of this article is to develop a system of costing which in coordination with the general accounts will produce current and reliable operating figures and afford effective accounting control.

The system suggested is based on standard cost procedures except in the case of ingredient (or material) pricing. Although standard quantity requirements can and should be determined, it is suggested that the determination of a standard price would be impractical because market fluctuations are so great. Persons qualified in food preparation for this type of catering should have no difficulty in preparing recipes which can be readily converted into material requirement standards.

The development of labour standards is somewhat more involved. For best results, qualified consultants should be engaged to perform this phase of the program. Labour requirements developed by experienced time and motion study experts should result in standard labour costs in their strictest interpretation. That is, the standard cost is the true cost and any variation therefrom is the result of extraneous circumstances and should be regarded not as a cost of production but a cost of the circumstance which gave rise to it.

In some instances, management may not desire such refinement. This does not mean that a system based on standard costs cannot be implemented. Predetermined estimates can

be developed by the accountant through the method of payroll and production analyses and be used as standard costs. Preparatory to such analysis, it is advisable that the accountant and production manager observe the methods with a view to improving procedures where there are obvious wasted motions and inefficiencies. It is also suggested that employees be fully instructed on the type of reports and information required. The importance of accuracy in reports, especially during the trial period, should be emphasized.

The next step in the preparation of the cost standards is the determination of a standard "kitchen or commissary overhead". The expenses for prior periods should be analyzed and from this information an estimate made for each expense account included in this classification. It is advisable that the schedule of estimates be discussed with key personnel. They may have opinions as to where economies can be effected or conversely where circumstances may cause certain expenses to increase in the future. When the necessary adjustments have been made and a total normal kitchen overhead cost established, it should be applied to a normal month's direct labour. The resultant rate can then be used to determine the standard overhead for the various items of production.

In the same manner that the kitchen overhead expenses are determined, it should be possible to estimate the distribution and administrative expenses. The total of these expenses when applied to the estimated sales volume will determine the gross margin percentage required in order to show a breakeven operation.

As standards are developed, a record should be set up showing in detail the calculated standard for each item of production. A meeting of management should then be called in order that standards may be fully approved before their implementation as a measure of cost and efficiency.

With the information now available, a budget can be set up for any operating period, preferably a month. In such an operation it is suggested that the budget be prepared in what might be termed as "reverse gear". That is, start with the monthly profit desired, then fill in the distribution and administrative expenses as determined. These together will total the gross margin required. The current monthly costs of direct labour and commissary expenses should then be inserted. The total to this point will determine the amount required over and above material costs.

With this information and a general idea of the sales potential, management can set a policy on the percentage of selling price allowable for material costs. This will, of course, vary somewhat in relation to the extent that direct labour costs vary from the average. However, such a general policy will act as a guide and should be sufficient to determine material costs and sales volume to complete the budget.

Making the System Work

The procedures necessary to put this information to work are fairly simple and centre on a form which we shall call the "requisition and production cost sheet". A suggested form, Exhibit 1 (see page 335) is designed for use in the type of catering where food is prepared in a cen-

tral kitchen and distributed to the workers in the plant.

When the day's menu is established this form is prepared in triplicate for each item on the menu. The information filled in at this time as obtained from the various standard costs sheets should be—

Item
Expected yield
Ingredients to be used
Loading instructions.

The routing of the form should be as follows:

Copy 1 – This copy should be forwarded to the storekeeper as his authority to issue the ingredients and then returned to the office with the required signatures as proof of issue and notification of adjustments if any. It should be noted that adjustments to the ingredients as called for should only be permitted if approved by the manager or a responsible assistant. If this precaution is not adhered to, material costs could conceivably vary from that percentage which the selling price of the item will allow.

Copy 2 – This copy should be used for loading purposes and determining and tracing the quantity produced. The person in charge of loading should record the following information:

Yield
Actual loadings
Returns.

The returns should be examined by the manager and allocated as to wastage, total reclaim or percentage of reclaim. It should be his responsibility to value the ingredients reclaimed giving consideration to their possible use in subsequent production and the relative replacement cost if so used. Based on this allocation, the loading clerk is able to complete the "production summary" and reconcile the total with the actual yield. This form should then be returned to the office.

Copy 3 – This copy is for office purposes.

The cost clerk's procedures should be as follows:

1. As soon as the form is received, the posting to perpetual inventory ingredient cards should be made. At the same time, the cost price of each item should be inserted on the forms and extended.
2. When copy 1 is received from stores, any alterations should be transferred to the office copy, entry made on the perpetual inventory cards and extended as above. Though this may appear to be a duplication, it should be pointed out that alterations to ingredient issues should be kept at a minimum and the time saved by the immediate posting and costing of ingredients is of greater importance than any minor duplication that may occur in this regard. Total and unit material costs should then be calculated.
3. When copy 2 is received from the loading clerk, labour and overhead standards should be inserted and totals extended based on the actual units produced.
4. Figures for wastage, staff usage and the credit for reclaimed ingredients should then be entered and the net cost of sales shown.
5. It is then suggested that wastage costs be added back to show their effect on the cost. The percentage of wastage to total net cost should be shown so that comparison may be made with what is deemed to be normal wastage.
6. The sales revenue can then be

EXHIBIT 1

REQUISITION AND PRODUCTION COST SHEET

ITEM________________ NUMBER________________

SELLING PRICE__________ DATE________________

YIELD - EXPECTED_____ ACTUAL_____

MATERIALS	Quantity	Price	Extension	Total
Reclaimed ingredients				
New ingredients				
Package materials				

	Extension	Total
Total materials		
Labour applied_____ units @_____		
Kitchen overhead_____ units @_____		
Total production cost		
Deduct:		
Staff usage_____ units @_____		
Wastage_____ units @_____		
Credit for reclaim		
Net cost exclusive of wastage		
Add back wastage		
Cost of_____ units sold		
Sales_____ units @_____		

DISTRIBUTION OF PRODUCTION

Location	Suggested Load	Actual Load	Returns	Sold
Total				
Staff usage				

Summary	Number of units
Total actual yield	
Sales	
Staff usage	
Wastage	
Reclaimed	
Total	
Value of reclaims	$
Approvals	
Issue of materials	
Loading clerk	
Manager	
Cost clerk	

Comments:

calculated by multiplying units sold by the unit selling price and a gross profit or loss shown for each item. The sales so determined should be reconciled each day with the sales analysis. This system offers a ready medium for preparation of a sales analysis in that the loading section shows the sales of each item at each location. This of course should be tallied with the cash received from each location.

7. Each "requisition and production sheet" should then be entered in detail to a "production journal", Exhibit 2 (see page 337). This journal, when prepared in duplicate, can serve as both a book of original entry and a report to management of the day's production and trading results.

An additional record book which can be of considerable assistance is a "record of reclaims". This will provide the cost clerk with a means of obtaining the transfer cost of reclaims used without referring back to the respective cost sheet. In addition, it will provide the manager with a ready reference of reclaimed ingredients on hand so that their use in production can be planned to minimize additional wastage losses.

Reports and Statements for Management

From the system, the following reports and statements can and should be prepared to keep management informed and assist them in maintaining effective control over the operations:

Daily

As previously stated, a copy of the daily production journal provides management with an indication of the sales, gross profit and wastage figures for each production item for the day.

Weekly

From the sales analysis and completed production cost sheets, a statement of sales, cost of sales and gross profit realized from any or all of the various serving locations can be prepared.

Monthly (or for four-week periods)

At the end of each month or four-week period, whichever is preferred, the following set of statements and reports should be prepared:

1. Analysis of sales by serving locations and items of production.
2. Analysis of cost of sales showing adjustment to actual costs where necessary.
3. Schedule of actual commissary expenses showing comparison with estimates.
4. Schedule of other actual expenses showing comparisons with estimates.
5. Profit and loss statement.

Along with these statements and schedules, a report should be submitted giving, where possible, causes for and suggested corrective measures for any of the following that may appear:

1. Expenses in excess of estimates.
2. Abnormal wastage costs.
3. Gross profits below estimated requirements.
4. Unabsorbed direct labour.
5. Unabsorbed overhead.

Expenses in excess of estimates should be explained in narrative form setting out the circumstances which occasioned the excess costs.

Abnormal wastage costs should also be covered by a narrative report.

DAILY PRODUCTION JOURNAL

EXHIBIT 2

Reclaimed Ingredients Used	New Ingredients Used	Package Materials Used	Labour Applied	Overhead Applied	Staff Usage	Reclaims	Wastage	Cost of Sales		Sales
								Excluding Wastage	Including Wastage	
Credit	Credit	Credit	Credit	Credit	Debit	Debit	Debit	Debit	Memo	Memo

The causes will usually be that a new menu item was poorly accepted and/or the ingredients used were not of a type suitable for reclaiming for future use.

Gross profits below estimated requirements should for the most part be explainable in schedule form showing the amount of abnormal wastage and/or material costs in excess of the predetermined percentage of selling price allowable.

Unabsorbed direct labour should be analyzed as to rate variance and efficiency variance as follows:

Actual hours worked at actual cost	–––
Less: Actual hours worked at standard rate	–––
Difference – Direct labour rate variance	
Actual hours worked at standard rate	–––
Less: Direct labour absorbed per production cost sheets	–––
Difference – Direct labour efficiency variance	

Unabsorbed overhead should be analyzed as to budget variance, capacity variance and efficiency variance as follows:

Actual commissary expenses	–––
Less: Budgeted commissary expense	–––
Difference – Budget variance	
Budget expenses	–––
Less: Actual direct labour hours at predetermined overhead rates	–––
Difference – Capacity variance	
Actual direct labour hours at predetermined overhead rates	–––
Less: Overhead absorbed per production costs sheets	–––
Difference – Efficiency variance	

Though the forms and system suggested are for the type of catering where the food is distributed to the employees in the plant, with proper production reports, sales analysis and wage and expense distributions they could readily be adapted to the cafeteria type of catering.

MENU WONDERLAND

In the wonderful world of the menu, the adjective is the greatest optimist, never daunted by past disappointments. No matter what the vegetable soup was like yesterday, today it is going to be *fresh* vegetable soup. Ever so limp, the coleslaw is *crisp*. In spite of sad experiences with peas, this time they are *garden green*. All menu beef is *choice*. Muffins naturally are *home made*. In the wonderland of the menu, pastry is *flaky* and griddle cakes are *old-fashioned*.

One of the Oxford Dictionary's definitions of adjective is: *not standing by itself*. In the menu world, nouns lean on adjectives and are carried up by adjectives to tree-ripened heights of enthusiasm. There is much good in this. Those who are born glum, or who have dined out too much, these may be expected to complain; but it is commendable that the mass of poor, stricken humanity has the spirit to ask expectantly for the *tempting* dessert.

—The Printed Word, February 1958

Estate Planning and Business Continuity

IRVING ROSEN

IN RECENT YEARS there has been a growing tendency for the business man to become estate-conscious. It has become necessary for him to see that his estate is planned in such a manner as to provide sufficient liquid assets to pay his succession duties when necessary. There is also a natural desire on his part to minimize these succession duties by forward planning.

Business perpetuation is becoming an increasingly important phase of estate planning. Broadly speaking, it can be defined as a plan for the continuation of the business of an individual, or small group of individuals, in such a way that his beneficiaries and all other interested parties inherit an income-producing operation whose asset position and profit potential remains unaffected to any serious extent by the death of the businessman. One result is the freezing of the businessman's interest in the firm so that the future appreciation of the business accrues to the intended owners. This would aid business perpetuation by reducing succession duties on the businessman's "frozen" estate.

In the examples that follow, circumstances have been made as general as possible, but it must be remembered that individual details are also very significant. Facts to consider are the age of the businessman and his children, the family's needs and wishes, outside income of the family, the desires and circumstances of the other partners or shareholders.

In business perpetuation, although some use is made of trust wills, gifts prior to death, and family life insurance, the principal tools involved are business insurance and agreements, and business reorganization.

Problems of Sole Proprietorship

A sole proprietorship or partnership is legally terminated upon the death of the owner or one of the partners. The amounts owing the creditors become due immediately and if disposal of the assets to meet creditors' claims is necessary, losses can vary from one-third to one-half of the business asset book values, depending on the condition and quick-sale value of the fixed, intangible and current assets. Not only is it desirable to continue the business so that the beneficiaries or other partners have an income-producing working organization, but it is obvious that a planned sale of a going concern will

bring a much higher price if the estate has time to give the business a fresh coat of paint and to overcome the disruption caused by the death. The liquidation of the business may sometimes be precipitated by the high impact of succession duties and and lack of sufficient liquid assets in the estate to cover payment of them. Another problem is that the other partners may be unwilling to continue in business with the widow, guardian, or executor who usually knows little of the business and would not be an active partner. This could increase costs, place an extra load of work on the surviving partners, and result in a return unsatisfactory to them.

Problems of Closely-Held Corporation

A closely-held corporation is in a no less vulnerable position than the partnership or proprietorship. If one of the major shareholders dies and there is no cash available to pay the succession duties, the estate may have to sell all or part of the shares. As there is a limited market for shares in a private company, the chances of getting full cash value on sale are unfavourable. The other alternative is to draw cash out of the business by declaring dividends, which imposes a heavy income tax on the estate and a severe strain on the business at a time when it can least afford it. In some cases it is necessary to sell part of the assets to obtain the cash required. Consequently, it is not unusual to find that "one-man" companies must be wound up on the death of the owner. Furthermore, in a partnership or corporation, the beneficiaries may sell their interest in the business to a stranger, who might not be acceptable to the other partners or shareholders.

Business Solutions

If the surviving partners, shareholders, or "key men" could buy out the interest of the deceased, a more workable situation would exist for all concerned. The new owners could run the business as they see fit and reap the profits of their endeavours. The beneficiaries would receive cash which could be invested more safely in high grade government and corporation securities, particularly chosen for safety and assured income. There are still several problems to face. The surviving partners, shareholders, or key men, must raise cash, usually a considerable amount, to buy out the decedent's interest. The beneficiaries must be willing to sell their interest in the firm. And lastly, a serious disagreement may arise as to the value of the decedent's interest.

Solutions of Sole Proprietorships

In one case of a sole proprietorship, sufficient life insurance was purchased on the proprietor's life by the wife who had a private income of her own, (or alternatively by the proprietor if no such income was available) so that the succession duties could be paid out of the proceeds and the business assets were left unimpaired. Provision was made in the will for the continuation of the business under the supervision of a trust company and professional managers. The firm could then be operated successfully until the son was ready to take over.

In another case, the proprietor's children were not interested in working in the business. The proprietor, whose net business worth was \$100,000, entered into an agreement with two trusted employees to pur-

chase an interest in the business when he died. Increased salaries were paid to the two key men to provide them with enough cash, after personal income taxes on the increase, to pay for part of the premiums for $100,000 life insurance on the life of the owner. A buy-sell agreement was then arranged, whereby each man was to pay $50,000 for an interest in the business, and the estate was to sell such interest on the death of the owner. Any increase in value above $100,000 was to be paid in instalments over a seven-year period. This would provide the estate with ready cash, increase the key men's loyalty and efficiency and assure a competent management.

Another term of the agreement was that the accountant was to draw up a statement annually to ascertain the going value of the business and its actual net worth. The last statement made before the owner's death was the basis upon which the interest to be sold to the key men was determined. It is to be noted that the premiums paid by the key men for the life insurance were deductible expenses by the business, as they were first paid out in the form of salary to the key men. This benefit was offset at least to some degree by the personal income taxes payable by these men on the amounts received. In this way the owner was guaranteed a market for his business upon his death.

Solutions of Partnerships

An appropriate solution in the case of a partnership was the use of a partnership business agreement complemented with business life insurance. A buy-sell agreement was entered into, in which the partners contracted to buy the decedent's share from his estate and the estate contracted to sell to the surviving partners. The purchase price or formula could vary, and could consist of a full cash payment made on the death of a partner or partial cash payment with instalments and interest payable on the balance owing. A valuation clause referring to the annual valuation statements prepared by the accountant was provided as a basis for the payments to be made. Special provisions were made as to the calculation of goodwill on an average earnings basis. These values, with reference to the statements prepared, were noted annually on the back of the agreement and signed by all the partners. They also supplied good grounds for the decedent's executors when settling the decedent's estate for succession duty valuation purposes.

A "criss-cross" life insurance arrangement was provided as part of the plan, to supply the funds for the purchase of the interest. Each partner's life was insured by the other two partners who paid the premiums on the insurance. A trustee was appointed to hold the agreement and the policies. When a partner died, and trustee could collect the insurance proceeds, follow the agreement's term, obtain the necessary releases to sell the deceased partner's interest to the remaining partners, and pay the insurance proceeds to the estate.

If, in the above case, the business were a corporation with three main shareholders, the same arrangement could be applied.

Solutions of Corporations

In another case, the corporation (not the shareholders personally) pur-

chased the life insurance. An agreement was entered into between the shareholders and the corporation that the proceeds would be used to purchase the decedent's shares and that the estate would sell the shares as above. One advantage was that the cost of insurance was borne proportionately by the shareholders which was not the case under the "criss-cross" plan, when there are large age differences between the shareholders. The premiums paid by the company were not deductible for income tax purposes and the proceeds received not taxable. The problem was how to distribute the proceeds to assist in buying out the interest of the decedent.

If the proceeds were distributed in the form of dividends out of accumulated earnings, the high amount of dividends received in a single year by the taxpayers would result in a confiscatory tax liability due to the high marginal rates of the income tax. However, the company could elect to utilize section 105 of the Income Tax Act. Under this section, an amount equal to the undistributed income on hand at the end of the 1949 taxation year could be distributed tax free into the hands of the shareholders, if the company elected to pay a 15% tax on this amount. Further, such distributions could be made, equal to dividends paid since the end of the 1949 taxation year upon the payment of a 15% tax by the company. The income tax burden was still quite heavy. The amount of life insurance could be increased to help pay for the taxes, i.e. insurance coverage would equal the amount required to purchase the shares from the estate and, as closely as possible, the income taxes payable on distribution.

Another Example

One company solved this problem in an interesting manner. The company had three shareholders, each having an equal interest in the firm. Each shareholder held $30,000 of common stock and the earned surplus was $36,000. The business showed signs of becoming very profitable in the near future but current assets would be tied up in expansion plans. The accountant discussed the situation with the firm's solicitor and insurance agent. A capital reorganization took place, replacing the previous rigid capital structure with a more useful one. As the shareholders took no wage bonus and the Income Tax Act provided a 20% tax credit on dividends received from taxable Canadian corporations, the taxes on the above dividends were small. Each shareholder converted his $30,000 common stock, par value $100 each, into 3,000 redeemable preferred voting shares, par value $10 each, and purchased another 1,500 preferred voting shares with the dividends received and private funds. Each shareholder then held 4,500 preferred shares worth $45,000. When one of the shareholders died, the company would receive $50,000 insurance proceeds. The company would then redeem 1,500 preferred shares from each shareholder, supplying the two survivors with $30,000, to be used to purchase the 3,000 shares remaining in the decedent's estate. The treatment of the common shares of the new company will be discussed below under "freezing of values".

One point should be emphasized with regard to buy-sell agreements for the continuation of a business. It is sometimes difficult to decide at an early stage just who the successors to

a business should be, and great care must be taken in choosing the parties. A business agreement is a means to an end, and not an end in itself.

Freezing of Values – General

An important feature of business perpetuation is the freezing of values of the business, in such a manner that the future growth of the firm will accrue to the prospective beneficiaries of the owner or owners. When a man with a sufficiently large estate has a growing expanding business, his succession duty problem is aggravated by the fact that he must find sufficient liquid assets or increase his personal insurance to cover the progressively higher tax he will have to pay. If, therefore, he can freeze the value of his interest in the business and hence the level of his estate, his succession duties can be minimized. Although a businessman may be willing to allow such an expanding value to pass directly to the ultimate beneficiaries, he will not be willing to give up control of the business and a plan must be devised so that control will still be held by him.

Freezing of Values – Proprietorships

A sole proprietor had a business worth $90,000. A corporation was formed with authorized share capital of $120,000 consisting of 1,500 common shares, par value $10 each, and 10,500 voting redeemable 6% preference shares, par value $10 each. The corporation issued 9,000 voting preference shares for the net assets of the sole proprietorship to the husband; 10 common shares for $100 to the wife; and 10 common shares for $100 to the son. By this means the future cumulative value of the business accrued to the wife and son as they held the common shares and benefit solely from the future growth. The husband retained control of the business as he held 9,000 voting shares. The value of the business in his estate was frozen, his interest being represented by preference stock with a value of $90,000 which in no way varied with the future growth of his business. Furthermore, if the wife and son purchased the shares out of their own resources, dividends of approximately $8,000 could be issued to each of the wife and the son with little income tax impact, as they were both in a relatively low tax bracket and the 20% dividend tax credit lessened the tax payable to a large extent. Their income would be considered to be the income of the sole proprietor, of course, if the wife and son purchased the shares out of gifts from him (and the son was under 21). The man could decrease his estate further if he so desired by given gifts of preference stock to his son, up to the extent that he wished the son to have control in the business.

A similar approach can be used in a partnership, but the problem is a bit more involved as each partner may not have a wife or a son who intends to enter the business. Nevertheless, incorporation along the above lines is desirable once the partners have ascertained in which way each of them desires his share of the future growth to be allocated.

Freezing of Values – Corporations

When a business is already incorporated, freezing of values can be accomplished by a capital reorganization. A new structure is obtained in which the authorized capital consists of voting redeemable preference stock and common shares. The use of the $1 or $10 par value share achieves greater flexibility for voting

and transfer purposes. Common shares are issued to the family for a suitable amount, and voting preference stock is issued for the previous common and preferred shares held by the businessman, and for the value of the surplus on the closing balance sheet. It should be noted, however, that there would be a deemed dividend to the extent of the undistributed income. If this amount is large and would incur too great an income tax, an alternative treatment would be to incorporate a new company and issue the desired amount of common stock to the family. The new company purchases the operating company from the major shareholder by issuing to him redeemable preferred voting shares in payment. The other tax implications of this arrangement should be considered before incorporating a new company. The acquisition of control of the operating company renders dividends paid out of the pre-acquisition surplus subject to the "designated surplus" provisions of the Income Tax Act in which case such dividends passing to the parent company are not tax exempt. If, however, the new corporation is a personal corporation, the dividends received by it will be taxable in the hands of the shareholders in any event.

Conclusion

Much more could be written on business perpetuation and the role played by the accountant. Although the lawyer, insurance agent, and trust company play an important part in the field of estate planning, it is readily acknowledged that where there is a business involved, the accountant is in a unique position to render service, because of his intimate knowledge of the business and his familiarity with the tax, capital and organizational aspects involved. The public accountant can only hope to attain the skill and knowledge necessary to deal with such estate problems by actual experience in varying situations. It is for each practitioner to create his own sphere of activity in this field and by doing so increase his scope.

A TRIFLE AMBIGUOUS

Extract from typed separation deed:—

"... and will pay to her for her support and maintenance an allowance of two pounds per week so long during the joint lives of the husband and wife she shall lead a chaste life on the Saturday of every week..."

— *Taxes*, December 1957

Operation Banking

Highlights of an address to the Canadian Club of Toronto in January by John S. Proctor, President, Imperial Bank of Canada.

On January 1, 1880, there were only 295 branches of chartered banks in the whole of Canada. Today there are 15 times as many—4,523—in this country and 149 in foreign lands.

Sometimes it is not realized that Canadians enjoy the heaviest concentration of banking facilities in relation to population of any people in the world. There is a branch bank for every 3700 Canadians. The comparable figure for Great Britain is one for every 4000 and for the United States, including unit banks and branches, one for every 8200.

The year 1880 was only nine years after the original Bank Act was first passed by the parliament of Canada. It was five years before the last spike was driven in the trans-continental line of the Canadian Pacific Railway by Lord Strathcona at Craigellachie. It marked the start of the first great period of rapid expansion of banking in this country, coinciding with the opening of the West.

This was an adventurous period in banking. Between 1890 and 1910, the number of branch banks in all parts of Canada increased from 426 to 2,368, more than five times in 20 years. This was the time when thousands of immigrants streamed into this country, when railroad building flourished and when metal mining, that great giant of our present-day economy, began in many sections. Canada, as we know it today, was being opened up and along with homesteaders, prospectors and land-hungry people from distant lands, came the pioneer bankers.

In the 10 years between 1901 and 1911, 816 bank branches were opened in the West, many in towns and villages long before the rails arrived. There were bankers in the Yukon who went over the trail of '98 to handle the dust of the sourdoughs. The first banker to arrive in Nelson, B.C., then a booming mining camp, walked the last 50 miles on snowshoes from the rail-end at Northport, Wash. His funds had not arrived and he had only $2.50 in his pocket. He managed to borrow $13.50 from a private banker, so that the Nelson branch of the Bank of Montreal opened the next day with $16 in cash.

The first branch in Grand Prairie in the Peace River district was opened after the whole staff travelled for 10 days through bush and muskeg and over frozen rivers to get there.

Branches were opened in tents,

lean-to's, granaries and all manner of temporary buildings, and sometimes in a corner grocery store. Many a tale has been told of managers sleeping on the cash at night because there was no safer place in town.

It was competition that drove these pioneer bankers into new settlements and new areas, opening up the country, and competition is just as keen and sustained today as it ever was. In Seven Islands, Que., when a branch of the Imperial Bank of Canada was opened a few years ago, space was rented in a barber shop while a building was being put up. At Leduc, Alta., in 1947, the day after the first producing well was completed, a branch of the Royal Bank opened for business in the town's council chamber, closing up whenever the town fathers held a meeting.

The story of the early days of banking in Newfoundland parallels very largely the story of the early banking days in the West and in the far North. A Mr. Girvan, manager of the Bank of Nova Scotia in Wesleyville in the early 20's, covered the north shore of Newfoundland in winter by catamaran and dog to get deposits for his bank. His story is typical of the early pioneer bankers. He slept with his dogs at night to protect his depositors' funds. On instructions of Thomas Fyshe, one of the great builders of the Bank of Nova Scotia, David Forgan, later called a tenderfoot in the great Northwest, left Halifax in March, 1882, with $40,000 of unsigned Bank of Nova Scotia notes strapped around his body and proceeded to Winnipeg via Minneapolis to open their first branch outside of the Maritimes. It was a memorable occasion. He was preceded, however, by the Bank of Montreal which opened the first permanent bank west of the Great Lakes in 1877 in Winnipeg; and others were there too.

The heavy concentration of banking facilities enjoyed by Canadians did not come about by accident. The compelling force has been competition among the banks for deposits, loans and revenue, and the desire of bankers to serve Canada and the Canadian people. Under the Canadian system, a chartered bank is a service institution, and to be successful it must keep up with population shifts and growth and economic developments of all sorts. That is why there is a branch of the Royal Bank at Frobisher Bay in the Arctic Islands and another branch only 28 miles from the Arctic Circle at Port Radium, in the Northwest Territories, with all supplies flown in by plane.

Each bank maintains a steady watch for localities where new branches can be opened. This constant drive for new business led to 682 branches being opened in the last five years, and 1,400 in the last 12 years.

Canadians have long enjoyed a banking system that is progressive and that keeps pace with the economic development of this nation and the demands of the banking public, a banking system that is second to none in any country in the world.

In recent years, and in many different ways, banking has been brought closer to the people. At one time, not so long ago, banking in this country — indeed, in all countries — was a class business. Only a comparatively small number of people used banking services; in fact, banks in those days made it plain they were

not particularly interested in the many but preferred the moneyed few. Today banks have put into practice the good business maxim that they are here to serve the many and without the many they could not survive.

The determination to provide services that many people want at prices they are prepared to pay has paid off. The latest figures for total deposit accounts for all banks is approximately 11 million, and for personal savings accounts 9,229,000. That means there is a bank account for practically every adult Canadian.

As of this moment, the chartered banks have in excess of 1,250,000 loans to individuals, corporations and governments on their books. The word "individuals" should be stressed because more than half the bank loans in Canada are for $500 or less. That is clear evidence that the banks of this country fulfil their role of looking after the banking needs of the small man, the average person in need of a few hundred dollars, as well as the budgetary requirements of industry or government that may run into millions.

This great expansion of banking and the remarkable increase in the number of people who use banking facilities in Canada have posed great problems in the executive end of the business. For instance, bank staffs have increased from 40,000 in 1947 to 62,000 in 1957. Still, banks are hard-pressed to maintain the high standards of service, the accuracy and the speed that Canadians have come to expect of the banking system. The total number of entries, debit as well as credit, that are made each year in all current and savings accounts stands at just under 600 million, nearly 2,350,000 every banking day. In 1949, the comparable figure was 375 million and in 1953, 475 million.

The banking system as a whole handles on the average approximately 2,500,000 cheques each working day, most of them handled several times as they are cleared back and forth to the banks where the accounts lie. This is a veritable flood of paper, and it all has to be handled speedily and accurately. Each branch of every bank in Canada balances every night.

Banking has reached a stage in Canada where a further increase in staff and the purchase of still more labour-saving machines are not enough to keep up with the flood of paper, in the form of cheques, drafts and deposit slips, that is threatening to overrun the dykes of efficiency and speed that have surrounded and featured the banking system of this country for generations. Fortunately for the banking system, this stage in development has been reached just as the electronics age has started and, fortunately for the banking public of Canada, the chartered banks never have hesitated to adopt new routines and new methods, no matter how costly, that will improve service to customers.

In the months to come, bank customers will hear and see a great deal about automation in banking. The time is rapidly approaching when electronic machines of all types will be introduced by the chartered banks to sort cheques and post ledgers automatically. They will be many times faster than conventional machines and as nearly errorless as a machine can be.

There is another aspect to all this bank expansion. It is difficult to generalize on the capital cost of a new

branch bank; there are too many variations as to size, location and type of structure; as to whether it is in an urban area or on the frontier, and as to whether it is in leased quarters or otherwise. Yet every time a chartered bank opens a new branch it spends perhaps $25,000 on the average in fitting it out alone. There is a vault to buy, counters, chairs, desks, safety deposit boxes, even the floor covering and acoustic tile. Where does that money go, the cost of the business machines and the plate glass, the desks, counters and all the other furnishings? It flows back through the retail, wholesale and manufacturing channels to provide jobs for Canadians.

Banks, in addition to many other things, are big customers of Canadian producers. They are, of course, large customers of the construction industry in both good times and bad. They buy vast quantities of supplies of all sorts; stationery alone runs into many millions of dollars a year.

There were 80,814 shareholders of the nine chartered banks in 1956 and of those, 60,822 were Canadians owning 73.45% of the shares. The number of shareholders has gone up from 53,983 in 1946 and 64,556 in 1951.

Dividends paid in 1957 aggregated $35,400,000. That represented 4.98% on the total shareholders' equity – a fair, but far from exorbitant, return. The average in the 10 years 1946-56 was 4.5%

Few industries get along on the narrow margin of profits of the banking business. Net profits of all chartered banks in 1956 averaged about one-third of a cent on each dollar of assets. Expressed in another way, the net profits of all banks in 1957, that is, after operating expenses, taxes, contributions to pension funds and depreciation allowances, was 6.50% of the shareholders' equity. A great many industries in this country have a much higher percentage of net profit than that.

For each dollar paid in dividends in 1956, banks paid $4.05 in interest to depositors; $5.26 to employees in salaries; $1.45 to governments as taxes and .44c to staff pension funds. In those four cost factors alone, for every dollar in dividends, banks paid out $11.20.

As a matter of interest, the total amount of income taxes paid by the chartered banks in 1957 amounted to $56,092,000. Obviously, the banking system, as evidenced by their recent annual reports, accepts the heavy tax burden to which it is subjected, but feels entitled to every possible assurance by governments that these vast amounts paid into the Treasury of this country are wisely and intelligently spent in the best interests of the Canadian people.

The rapid expansion of more than two years' duration appears to have reached its culmination early last year. The situation today is mixed and apparently we have entered a phase of readjustment. The size of our growth was impressive and imposed many problems. Canada's difficulties with inflation in recent years have been mild indeed in comparison with those of many other countries. We have been especially fortunate in our balance of payments position. In some European countries, by contrast, the financing of merchandise import deficits has been so acute a problem that spending on investments has had to be sharply curtailed even though future national competitive capacity and standard of living has

thereby been endangered. That no significant curtailment of the growth of our national productive capacity has been required is due to our power to attract a heavy inflow of people and capital from other countries. The size of this inflow is evidence not only of our potential wealth but also of the confidence displayed by other countries in the soundness of our economic policies. If we continue to conduct our affairs with skill and flexibility, we should not forfeit their good opinion.

Beyond all the influences tending to moderate any decline is the basic fact that the prospects of the Canadian economy have not so worsened as to make necessary any substantial revision of long-term plans for investment spending by Canadian businessmen. We should be able to pay good wages to our people and sell our main export commodities on a competitive basis on world markets in spite of the difficulties which are bound to be encountered with particular products and particular industries from time to time. The fall in stock prices and mixed behaviour of industrial production in different lines of business give no grounds for panicky apprehension of severe depression. The resumption of economic growth throughout Canada will depend primarily both on improvements of productivity and moderation in wage demands. Canadians are well endowed with imaginative and enterprising leadership. We are a disciplined and responsible people and if we use fully these qualities we have sound ground for confidence in ourselves and in our future. In the early resumption of Canada's economic growth, "Operation – Banking" will play a constructive and leading role as it has done through the years.

THE ACCOUNTANT AND AUTOMATION

The growing complexity of modern industry and commerce has been met by the accountancy profession evolving new procedures, but as business increases its demands, so it also requires greater speed in the provision of the information needed for efficient management. This has resulted in the accountant calling into collaboration the mechanical and electronic engineer.

We hear a lot about mechanization or, as it is also known, "automation". The accountant, if he stands up to the challenge, has nothing to fear from automation. He should welcome it for it will relieve him of the drudgery of his profession and give him increased opportunity to use his time more effectively. It is up to the accountant himself. Depending on his thinking and attitude to the challenge of automation he can become a slave to the machine or he can use the machine as a tool and be its master.

– "The Historical Development of Accounting" in *The Australian Accountant*, January 1958.

Edited by LAWRENCE G. MACPHERSON, F.C.A.

Accounting Research

Director of Research, C.I.C.A.

The Meaning of "Market" In Inventory Valuation

The phrases which are most commonly used on balance sheets to describe the basis of valuation of inventories could not properly be included in a list of easy accounting terms. The words "cost" and "market" are deceptively simple in form but, like other abstract terms, they are symbols of complicated concepts.

The meaning of "cost" was the subject of Bulletin No. 5, published by the Research Committee in November 1950. The C.I.C.A.has not as yet published a statement on the meaning of "market". Efforts intended to produce a useful and understandable definition seem often to turn toward an involved formula instead, which might serve to increase accountants' understanding of "the lower of cost or market", but does not do much to improve the intelligibility of financial statements generally.

The difficulty of applying, and interpreting, the basis of "lower of cost or market" may be indicated by a sort of miniature accounting I.Q. test. First, read the rule of "cost or market, which ever is lower," as defined in the American Institute's Accounting Research Bulletin No. 43, p. 31:

> As used in the phrase "lower of cost or market" the term "market" means current replacement cost (by purchase or by reproduction, as the case may be) except that:
>
> (1) Market should not exceed the net realizable value (i.e. estimated selling price in the ordinary course of business less reasonably predictable costs of completion and disposal); and
>
> (2) Market should not be less than net realizable value reduced by an allowance for an approximately normal profit margin.

Now, for the test, select the appropriate inventory valuation in each of the following cases, noticing also your billable time for the whole operation:

	Cases 1	2	3	4
Cost	100	100	100	100
Replacement cost	95	95	90	90
Realizable value	110	90	112	95
Realizable value less normal profit	99	80	101	85

* * * *

The quotation from the American Institute bulletin defines "market" primarily in terms of replacement cost, but not exclusively so. Realizable value is substituted where realizable value is less than replacement cost. Presumably the rule means that "market" is to be taken as the lower of replacement cost and net realizable value, except that "market" should not be less than realizable value reduced by normal profit.

In each of the four cases set out in the test, the third and fourth prices are the upper and lower limits of market, according to the American Institute bulletin. In ordinary applications of the rule, one would select historical cost or replacement cost, whichever is lower, as the inventory pricing, if it falls between realizable value and realizable value less normal

profit. In our test cases, however, this occurs only in number 4, where replacement cost of 90 is less than cost, and falls between realizable value and realizable value less profit. Replacement cost, therefore, is appropriate in this case, according to the rule of "market".

In case 1, replacement cost is less than cost, and so should be considered. But realizable value less profit is greater than replacement cost, and therefore it represents the minimum figure that can be taken as market. In this case, therefore, market is 99, and presumably this is the inventory price. This pricing, however, introduces a small loss in the current period for the purpose of allowing a larger profit to be reported in the succeeding period. This shifting of profits from one period to another is disliked by many accountants, who would in this case use cost, 100, as the inventory price; but this is not the rule of "lower of cost or market" where market "means current replacement cost", as proposed in the American Institute bulletin.

The circumstances in case 2 direct attention to the prices below replacement cost. Realizable value is less than replacement cost, and is therefore to be used as inventory value. In this situation, realizable value less profit should not be used, because, as *Montgomery's Auditing* suggests, this would result "merely in shifting profits from one period to the succeeding period". Montgomery recognizes exceptions to this, as in the retail inventory method.

Case 3, admittedly, would be a rare case, for selling price has risen while replacement cost has fallen. Replacement cost is less than realizable value, and would be selected as "market", were it not for the rule that market should not be less than realizable value less normal profit. Accordingly, the inventory value here is cost, 100.

Now, the score. The writer is not a psychologist, so each candidate is free to grade himself as he sees fit. Anyone who selected four correct answers within five minutes should consider himself a genius. All others who tried the four parts of the test must be rated as specially gifted, since they obviously are endowed with unusual initiative and fortitude.

The examples given suggest that such a broad interpretation of the meaning of "market" will not make financial statements more intelligible to most readers. It may add to the usefulness of the statements to experienced accountants, but other readers will continue to be perplexed by such a flexible definition of the term. The American Institute committee points out that its statement on "cost or market" is intended as a guide rather than a literal rule, because of the many variations of circumstances encountered in inventory pricing. Accordingly, accountants should continue to seek something better, striving always to avoid useless jargon and a cult of interpretation.

* * * *

The English Institute seems to have found a solution which promises to increase general understanding, where the American solution offers a measure of clarity to the initiated specialist alone. The English recommendation limits "market" to realizable value, but allows the use of replacement value if the description in the balance sheet is worded "at the lower cost or replacement value". The recommendation reads as follows:

Market value should be calculated by

reference to the price at which it is estimated that the stock-in-trade can be realized, either in its existing condition or as incorporated in the product normally sold, after allowing for expenditure to be incurred before disposal. In estimating this price, regard should be had to abnormal and obsolete stocks, the trend of the market and the prospects of disposal.

If the value of stock-in-trade is calculated by reference to replacement cost, it should be described in the balance sheet as being "at the lower of cost or replacement value", but in no case should it exceed market value as described above.

This wording seems to leave no room for the deduction of the normal profit margin from realizable value, and so would not embrace the retail inventory method. Perhaps it is intended that some other description should be used in such cases.

The recommendation does not suggest a description to be used in cases in which part of the inventory might be valued at cost, part at market, and part at replacement value. This might occur where the general rule was "cost or replacement value", but where the realizable value of certain items had fallen below the replacement value. This would be an exceptional situation, but it could occur. Perhaps it is intended to be embraced by the description "at lower of cost or replacement value", but it does not fit into that phrase.

° ° ° °

Comments on the meaning of "market", by some members of the Research Committee

1. "I feel inclined to the view that the meaning of "market" should be narrowed down. . . . I favour some form of limitation such as 'Estimated replacement cost but not less than estimated realizable value less normal mark up, and not more than estimated realizable value less estimated costs of completion and disposal'."

2. "I think the Committee on Accounting and Auditing Research should endeavour to clarify the meaning of 'market' . . . . I consider that market means the estimated or current replacement cost and that in no case should market exceed the estimated selling price in the ordinary course of business, less a reasonable estimate for costs of completion and disposal and a reasonable allowance for a normal profit margin. I do not consider that we should set a specific rule but offer general guidance to members and indicate exceptions which would result from unusual circumstances."

3. "Where, in valuing an inventory at market, the basis used is net realizable value reduced by an allowance for an approximately normal profit margin, it could be argued that the effect is to transfer profits into a future year by taking up losses in the current year. I have some doubts as to the desirability of this procedure, although I appreciate that it is more or less inherent in the retail method of inventory valuation, where the normal gross profit mark-up percentage is applied to retail inventory valuations after reducing them by markdowns of goods on hand.

"In most instances, I think the fairest basis of valuation is to arrive at market by using the estimated realizable value less the estimated costs of completion and disposal or the estimated replacement cost, whichever is the lower.

"On balance, my inclination would be to leave the definition of the term 'market' along the lines of that set out in the bulletin of the American

Institute of Certified Public Accountants but to indicate a preference for the use of the realizable value, less the estimated costs of completion and disposal, and to recommend that where net realizable value is reduced by an allowance for profit margin, it should be so indicated in the financial statements."

4. "I find that in our experience the term 'market' as applied to inventories represents the amount emerging from the use of any one of the following bases of valuation:

(a) Current replacement cost, either through purchase or manufacture;

(b) Net realizable value, i.e. total estimated selling price less cost of selling; and

(c) The same as (b) except for a further deduction in respect of a normal margin of profit.

"The valuation described in (c) has been the subject of discussion by accountants for many years, and it is probable that there is no degree of unanimity in regard to the acceptability of this basis of valuation. I have noticed a preference in recent years for basis (b). I would think in practice that in some circumstances we could not take serious exception to basis (c)."

5. "Discussions on inventory valuation usually seem to consist of hashing and re-hashing definitions of replacement cost, realizable value, etc. A discussion of such points is valuable, but it should not be forgotten that even if these definitions were settled in a satisfactory way, many almost more important problems would remain to face anyone attempting to establish inventory values that are acceptable in preparing accurate statements. It is all very well to decide, for example, that inventory should be priced at realizable value in certain instances, but the problem still remains of establishing the basic facts to which an agreed formula would be applied.

"The determination of what certain goods will realize on being sold, or what it would cost to replace them, are matters which must require judgment or even guess work. The accountant who disclaims any responsibility, or right, to decide on questions of obsolescence is, of course, correct. This must be left to experts on merchandising who can be expected to make only somewhat better guesses than might the accountant himself. Saleability and other considerations involve, in many instances, rather wild guess work. This should be remembered when theorizing on what formulas should be used in determining inventory values. It is not very helpful to over-refine theoretical reasoning, when the basic data to which the theories will be applied is so uncertain.

"Another important consideration in the practical determination of inventory values is the variety of circumstances encountered, not only when comparing different companies, but within the same company. Such questions are frequently asked as – 'What is the basis for valuing the inventory?' as though it were normal to value all items in an inventory on the same basis. However, many larger corporations have a great variety in inventory and different types of goods must be valued on different bases as seems most appropriate in each case. This is inevitable, and many different illustrations could be given. For example, there is the question of goods subject to model changes each year as automobiles, radios and electrical appliances. It is rarely (and only by

accident) that model years coincide with fiscal years, and the problem is thus presented of stocks of goods in inventory at the year end which must be disposed of before the new models come out some months hence. This requires an estimate of the price reductions which will be necessary to clear out the old lines, and an important factor is introduced which will not apply to other sections of the same company's inventory.

"Perhaps one useful approach would be to start at the outset by reviewing the basic objective in inventory valuation. For instance, we might remind ourselves that no problem at all arises in the case of a manufacturing company operating profitably in an economy with stable prices. The cost of manufacture is the proper basis for inventory valuation. Complications in calculating realizable or replacement values arise only when one tries to take into consideration changes in the price structure of the economy. When prices are all rising, there is still no problem, as the principle is well established that such favourable trends (from a profit viewpoint) should not be taken into account. In short, the complications, on which so much time is spent, arise only when certain unfavourable variations occur, such as a drop in price of either product or raw material. In the light of the generally accepted accounting maxim that reasonably foreseeable losses should be anticipated, a writedown below cost is clearly required. The whole problem is how such writedown should be calculated.

"At this point it might be well to remember that financial statements are utilitarian. The right course of action in any case is the course which will produce the most useful results. The problem is to find what the most useful rules would be in such circumstances.

"When assessing usefulness, we immediately encounter the fact that a number of different types of people have recourse to financial statements – each group with its own purposes. The three essential groups are creditors, investors (including in this context the Tax Department) and management. To satisfy the creditor group is relatively simple, as the further the inventories are written down the safer they will feel. On the other hand, the investor group requires the most reasonable matching of costs against revenues – because they want to know the company's performance to form opinions on the value of its shares, (which is largely a question of producing an accurate earnings figure). In a general way, investors should want a matching of revenues and expenses with some 'conservative' bias. The requirements of management are a little different again. They are interested principally in operating efficiency, and a conservative bias has no place in their calculations. In this sense they have perhaps the most detached point of view of all.

"These considerations raise far more questions than they settle, but perhaps that might be useful in stimulating thought on aspects of the problem that do not get discussed too frequently."

BY JOHN W. CROWE, C.A.

Administrative Accounting

Corporate Financing — I

While there are many interesting problems associated with the raising of corporate funds, fundamentally a choice must usually be made between some form of indebtedness such as debentures or mortgage bonds and the issue of additional common stock.

It is proposed to limit the subject here to the somewhat narrow, yet obviously important, question of the cash "costs" of each form of financing to a going corporation. In this sense (perhaps unorthodox) dividends on common stock represent the "cost" of that form of financing just as interest payments represent the cost of carrying debentures. A subsequent article will take the broader approach of exploring some of the effects of each form of financing upon the continuing interests of common shareholders.

Annual Carrying Costs

In assessing the continuing annual cash outlays required of a corporation to service each method of financing an obvious course is to compare the currently expected interest rate on a new issue of debentures with the current dividend rate for common stock. A simple example is as follows:

Expected interest rate on new debentures	6%
Current dividend rate	50c a share
Expected issue price of new common stock	$10 a share

If $1,000,000 of new debentures were issued at par at 6%, the gross carrying cost would be $60,000 per year. Allowing for income taxes at 50% this would represent a net outlay by the company of $30,000 per year or 3% of the new funds obtained. On the other hand to raise $1,000,000 by common stock at $10 a share would involve the issue of 100,000 shares. At 50 cents a share this would mean additional dividend payments of $50,000 a year or 5% of the funds obtained. On this basis, largely from the impact of corporate income taxes, it would seem that an issue of debentures would be much more advantageous from a cash standpoint than an issue of common stock.

Is this conclusion really sound? Is it not a static answer to a dynamic situation? It carries the assumption that total dividend payments will continue to be governed by the following simple relationship:

Number of shares outstanding)
Current rate of dividends a share) ► Total dividend payments

A moment's reflection must lead one to suspect that this is a very short-term and shallow equation for most operating companies. Generally speaking, total dividend payments will sooner or later be determined by more fundamental factors. These consist of such objective, but variable, matters as profits, rate of capital expansion and the resulting state of financial resources and such intang-

ibles as the business philosophy of the Board of Directors. In other words the real longer term relationships governing the level of dividend payments are probably as follows:

Financial resources (Level of profits, rate of capital expansion etc.))	▶ Total dividend a share
Intangibles (Conservatism of Bd. of Directors, etc.))	

In this longer-term scheme of things, the chief effect of changes in shares outstanding is on the rate of dividends a share as follows:

Total dividend payments)	▶ Rate of dividend payments
Number of shares outstanding)	

After a new issue of common stock, there would undoubtedly be powerful resistance to any reduction in the prevailing rate of dividends a share. Therefore, for sometime at least, there might well be an increase in total dividend payments proportionate to the increase in stock. In the longer run, however, and particularly if we can assume that profits are increasing this would not necessarily be the case. Following the longer-term relationship shown above, an increase in stock outstanding might have relatively little lasting effect on the total of dividend payments, but might merely result in a slowing down in the rate of growth of dividends a share. To show the application of this line of thought an example is developed in Table 1 (see page 358).

The table shows the pertinent facts for the years preceding and following the raising of new funds of $1,000,000, alternatively by issuing 6% debentures and 100,000 common shares at $10. The annual debenture cost, of course, is automatically fixed at $30,000 (after taxes of 50%) or 3% of the funds raised. The cash carrying cost of an issue of common stock will be the increase in dividends which will result from the issue. In other words the company faces two choices. One is to finance by debentures and pay interest plus a certain level of dividends. The other is to finance by more common stock and pay no interest but presumably increased total dividends. What is the probable increase in dividend payments due to an issue of common stock?

If a company is expanding it will almost certainly be plowing into capital investment a considerable and perhaps increasing portion of its annual earnings. For simplicity in the example, we have assumed that the company is in the habit of distributing 50% of annual profits as dividends. If financing is accomplished by debentures, a projection (Table 1) of dividends at 50% of forecast net profits is as follows:

	Amount	Rate a share (500,000 shares)
1958	$250,000	50c
1959	265,000	52.5
1960	285,000	57
1961	300,000	60

In estimating total dividend payments following an issue of 100,000 shares of common stock, it has been assumed that (1) there must be no reduction in the rate of dividends prevailing at the time of financing, i.e. 50 cents a share; (2) the shareholders must continue to receive as dividends at least 50% of annual profits. On this basis a forecast of dividends (Table 1) in the years after common stock financing is as follows:

	Amount	Rate a share on (600,000 shares)
1958	$300,000	50c
1959	300,000	50
1960	300,000	50
1961	315,000	52.5

The "cost" to the corporation of financing by the common stock issue therefore consists of the following increases in annual dividends occasioned by the issue (i.e. the increases over what would probably be disbursed were the new funds obtained from some other source, such as debentures):

	Amount	% of new funds
1958	$50,000	5%
1959	35,000	3.5
1960	15,000	1.5
1961	15,000	1.5

In the first year of the new financing, the cost to the company of a common stock issue is equivalent to 5% or equal to the ratio of the current dividend rate of 50c to the issue price of $10 a share. However, that is the only year in which this simple relationship prevails. Thereafter the annual cost of the financing through a stock issue tends to drop rather sharply. It is emphasized that this projection allows for maintaining both the current dividend rate and the practice of paying out at least 50% of profits in dividends.

What happens if profits decline instead of increasing? In the example, as long as dividends are maintained, in the face of declining profits, at the current rate of 50c a share there can be no disputing that the cost of a stock issue would be 5% per annum as against a supposed debenture cost of 3% per annum. However, can a fixed dividend rate be indefinitely maintained in such circumstances? Sooner or later dividends must surely decline with declining earnings. In a dynamic situation like this, a stock issue might again prove to be much the cheaper form of financing. Only if it is assumed that dividends a share are frozen at their current levels (i.e. will neither increase nor decrease) is it permissible to weigh the relative costs of stock and debenture issues by simply comparing the current dividend rate with the current interest rate after taxes.

In short the requirement to pay dividends on a new stock issue is a very flexible obligation compared with that of paying interest on funded debt. For this reason, despite the impact of taxation and despite relatively high current dividend rates, it will generally be cheaper from a purely corporate cash point of view in the longer run to finance through common stock than through debentures. So long as current dividend rates are not deemed irrevocably fixed, this conclusion would appear to be valid whether it is expected that profits in future years will increase or decrease.

Issuing Price of Debentures

To issue debentures at a discount of course means an increase in the effective annual carrying cost. The scientific method of determining the effective annual rate of interest cost when debentures are issued at other than face value is precisely the same as the "discounted cash flow" technique for estimating the return on a new capital investment as discussed briefly in this department in February 1958. It is also identical with the method used in the article "Own, Lease-Back or Rent"? (Administrative Accounting, December 1957). To take a simple example, suppose 20 year 6% debentures are issued at $95. The issuing company receives $95 now.

Table 1

Debenture Issue in 1958

6% – $1,000,000

Amounts in Thousands

	Net Profit	Amount of dividends (50% of net profit)	Rate of dividends based on 500,000 shares	Debenture Interest: Amount after taxes	Debenture Interest: % of funds raised
1955	$450	$225	45c	–	–
1956	475	240	47.5	–	–
1957	500	250	50	–	–
1958	500[1]	250	50	30	3%
1959	530[1]	265	52.5	30	3%
1960	570[1]	285	57	30	3%
1961	600[1]	300	60	30	3%

Issue of Common Stock in 1958

100,000 shares @ $10

	Net Profit[2]	Dividends[3]: Amount	Dividends[3]: Rate (on 600,000 shares)	Increase in Dividends: Amount	Increase in Dividends: % of funds raised
1958	$530	$300	50c	$50	5%
1959	560	300	50	35	3.5
1960	600	300	50	15	1.5
1961	630	315	52.5	15	1.5

[1] Forecast, after deducting net debenture costs.

[2] Reflects saving of net debenture costs.

[3] Maintains both prevailing rate and practice of distributing at least 50% of profits.

The company pays out a net interest cost of $3 per year (i.e. 6% of $100 less 50% for income taxes) over 20 years and the final redemption, assuming no sinking fund, of $100 at the end of the period. The effective rate of interest on an issue like this is the rate at which it is necessary to discount the combination of $100 at the end of 20 years and an annuity of $3 for 20 years to equal $95 today. The discount is not allowed as a charge against taxable income and this is in effect taken into account by the above technique. A formula which gives a good approximation of the effective annual percentage cost is as follows:

$$\frac{\dfrac{\text{Amt. of discount}}{\text{No. years}} + \begin{array}{c}\text{Amt. of annual interest}\\ \text{(Less income tax effect)}\end{array}}{\dfrac{\text{Issue price} + \text{Face value}}{2}}$$

Using this formula and the example mentioned above the effective annual interest cost would be:

$$\frac{\dfrac{\$5}{20} + 50\%\text{ of }\$6}{\dfrac{\$95 + \$100}{2}} = 3.33\%$$

With 20 year 6% debentures and a 50% income tax rate each 1% discount in the issuing price is equivalent to an increase of about .065% in the effective average annual carrying cost.

Issuing Price of Common Stock

If financing is through an issue of common stock, the new stock is usually sold at somewhat below the current market price. This is generally accomplished by issuing rights to existing shareholders to purchase at a stated price a block of new shares in some proportion to the number presently held. These rights of course have a market value. The greater the discount of the issuing price of the new stock from the current market price of the stock the greater is the value of the rights.

From the cash viewpoint of a corporation as a continuing legal entity, what are the considerations in setting the price of a new issue of common stock? In the case of debentures as seen above, an increase in the discount is directly and irrevocably reflected in an increase in the annual carrying cost of the new financing. Does the same logic apply in the case of common stock?

In the example summarized in Table 1, let us assume that $1,000,000 is raised by issuing new common stock at $9 instead of $10 a share. Clearly, about 110,000 shares will now have to be issued instead of 100,000 shares as was formerly the case. If we maintain a dividend rate of 50 cents a share we will have an additional expenditure in dividends (initially at least) of 50 cents on 10,000 shares or $5,000 per year. This is equivalent to ½ of 1% per annum on the funds raised. Is this a continuing annual expenditure?

Again the problem arises as to whether the current dividend rate is really fixed. Let us assume that we have a dynamic situation in which the dividend rate is expected either to increase or decrease in relation to financial resources. In this event the total amount of dividends each year will be determined by a company's capacity to pay having regard to earnings, plans for expansion and other variable factors. The number of shares outstanding, whether 100,000 or 110,000, will therefore have a bearing on the rate of dividends a share but, perhaps, very little on the sum of dividends disbursed. Let us project the amount of annual dividends using the example of Table 1 assuming the $1,000,000 is raised by issuing approximately 110,000 shares at $9 instead of 100,000 shares at $10. We can continue the same rules, namely the current dividend rate (50c a share) must not be decreased and that at least 50% of earnings must be disbursed to shareholders. The dividends on this basis would become:

	Amount	A share on 610,000 shares
1958	$305,000	50c
1959	305,000	50
1960	305,000	50
1961	315,000	51.5

For the first three years dividends would be $5,000 higher than if the stock had been issued at $10. By the fourth year, however, the rate of increase a share is merely somewhat less than might otherwise have occurred and the total dollar dividend remains unaffected at $315,000 or 50% of earnings. In other words if the dividend rate of a company is tending to increase, this rate of increase will be slowed down by having more

shares issued at a lower price. There will, however, not normally be any continuing annual out-of-pocket cost to the company.

The foregoing leads in the direction of the proposition that the price set on a new issue of stock is not from a purely corporate cash point of view a matter of much importance. It is probably demonstrably true that in many cases reductions in the issue price of new stock do not represent long-term cash costs to the issuing corporation. The situation is distinctly different from that in the case of issuing debentures. There is, however, a most important problem of public relations. Successive issues of new stock at prices well below current market values might rapidly reduce a company's stock to the "penny class". This might reflect disadvantageously on a corporation and particularly on its management. If the practice of issuing new shares cheaply were carried to extreme a company might show a record of declining earnings and dividends a share even though it was really achieving a very satisfactory rate of growth in total assets, total profits, and return on investment. The proposition still holds, however, that a moderate discount below the market price in the issue of common stock does not necessarily represent a hard financial cost in the same manner as debenture discount.

It is emphasized that the foregoing presentation of some of the many problems in financing has been from the viewpoint of the financial management of a corporation considering the cash carrying "cost" of different ways of raising money. From this approach it can be shown that the financial cost to a company of an issue of common stock will in the long run, in most cases, be appreciably less than for an issue of debentures. Only if the dividend rate can be assumed to be completely inflexible (i.e. will neither increase nor decrease with changing circumstances) is this proposition likely to fail. In most companies total dividend payments will be determined by such fundamental variables as profits, capital expansion and corporate philosophy. In this context, increases in the number of shares outstanding will tend to retard growth (and accelerate declines) in the rate of dividends a share, but may have comparatively small effect on the sum of annual dividend payments.

Considering the overriding interests of shareholders, however, there are other powerful considerations. Perhaps foremost among these is the matter of leverage produced by debenture issues. As already stated, this viewpoint will be emphasized in a subsequent article.

This is the first of two articles. The second will be published in June 1958

BY CAMPBELL W. LEACH, C.A.

Tax Review

THIS DEPARTMENT will, in the ensuing months, add to the leading article two new sections which will deal with changes in the law and recent tax cases. The usual word of warning must be added: these commentaries will be largely non-technical and are no substitute for the statutes, the regulations or the texts of the cases. All cases may not be reported because the objective will be to select those which are most newsworthy. It is hoped that a short summary of the occurrences in these two areas will be helpful to those of our readers who cannot devote the time required for reading the complete texts and commentaries.

Our readers are reminded that the editor of the Tax Review will be pleased to receive contributions, suggestions, comments or criticisms at any time, because only in this way can it be judged whether or not the published material is interesting.

* * *

Expenses of Officers and Employees

The recent commotion in the United States over reimbursed expenses has aroused interest in the whole subject of employees' expenses and allowances. As many readers know, the Internal Revenue Service of the United States will, for 1958 and subsequent years, require all employees to show as income all amounts received from their employers in reimbursement of expenses. This new requirement has been deferred until 1958 because of the protests of taxpayers but will apply to even the smallest items, such as taxi fares, overtime meals, etc. It follows, of course, that employees will be permitted to claim as a deduction from their income the amounts actually spent by them. This procedure has been instituted by the Internal Revenue Service so that they will know how much employees are receiving from their employers as expense reimbursement, which will enable them to detect unreasonable situations. It is quite conceivable that employees will in future be taxed on the amounts by which their expense accounts have been "padded".

Under Canadian income tax law, employees are not required to include such amounts in their income because the employee is looked upon as the agent of the employer when he pays for such expenses and the subsequent reimbursement is not income to him. However, the Department of National Revenue in Canada, like the U.S. Internal Revenue Service, is concerned about the benefits that employees may be receiving in this way and seems to be enforcing the law more strictly than heretofore. The 1956 amendment to section 5 which added the words "of any kind whatsoever" to the paragraph concerning board, lodging and other benefits has apparently given the law more teeth with which to bite

this type of benefit. At the present time, however, rather than attempt to tax the employee on the amount by which his expense account may be "padded" (or at least unvouchered), the Taxation Division is merely disallowing the expense in the hands of the employer. However, under the law, such amounts can be included in the income of employees; employers should, therefore, be cautioned against accepting expense accounts which are not properly substantiated.

With respect to officers and employees, section 5 of the Income Tax Act provides that income from an office or employment is:

a) the salary, wages and other remuneration including gratuities received by the taxpayer in the year, plus

b) the value of board, lodging and other benefits of any kind whatsoever received or enjoyed by him during the year, and

c) all amounts received by him in the year as an allowance for personal living expenses or as an allowance for any other purpose.

This section, which of course governs all types of employees, provides for certain specific exclusions and deductions from the above but then ends with the words "but without any other deductions whatsoever". As a result, employees attempting to claim deductions from their employment income must be certain that they are specifically provided for in the Act or they will be disallowed even if they are reasonable expenses incurred to earn that income. The more common permissible deductions include such items as annual professional or union dues, office rents, salaries and the cost of supplies which the employee is required to pay. In addition, there is excluded from employment income the benefits derived from employer contributions to a registered pension fund, group insurance plan, medical service plan or supplementary unemployment benefit plan as well as certain allowances for travelling expenses, of which three are of general interest.

Construction Workers

Travelling allowances received by construction workers, along with the value of or reasonable allowance for board and lodging, are excluded from income in certain cases. To qualify for exclusion, the allowance must be received while the individual is employed at a construction site which is sufficiently distant from his residence that he could not be expected to travel daily from his home to the site. Also excluded are such allowances received when the individual is required by reason of his duties to be away from his residence for a period of 36 hours or more. In order to qualify, the construction worker must maintain a domestic establishment in which he ordinarily resides and in which he actually supports a spouse or dependent blood relative.

Salesmen

Reasonable allowances for travelling expenses are excluded from income when they are received by an employee in respect of a period when he was employed in connection with the selling of property or negotiating of contracts for his employer. However, by virtue of section 11(6), salesmen may deduct all amounts expended by them for the purpose of earning their income provided all of the following conditions are met:

a) they are required to pay their own expenses,
b) they ordinarily carry on their duties away from their employer's place of business,
c) they are remunerated in whole or in part by commissions or other similar amounts fixed by reference to the volume of sales made or the contracts negotiated,
d) they are not in receipt of a reasonable allowance for travelling expenses which is excluded from their income.

It should be noted that, technically speaking, the receipt of a reasonable allowance for travelling expenses will disqualify salesmen from deducting any expenses whatsoever. It is known, however, that in some instances salesmen have been allowed to deduct entertainment and other expenses even though they were in receipt of a reasonable travelling allowance. While this procedure may be equitable in the circumstances, it is questionable whether it does not contravene the Act. To be safe, salesmen might, in such cases, arrange to receive their travelling allowances in some other manner which would then be part of their income. On the other hand, if the travelling allowance does not fully cover such expenses, it may be possible to contend that the allowance is not reasonable, add it to income and then deduct all expenses.

Other Employees

Reasonable allowances for travelling expenses are also excluded from income where they are received by an employee not employed in connection with the selling of property or negotiating of contracts for his employer if the allowances were computed by reference to time actually spent travelling away from the municipality or metropolitan area, if there is one, where the employer's establishment is located. Section 11(9) provides that such salaried officers and employees who are ordinarily required to carry on their duties away from the employer's place of business, and to pay their own travelling expenses, may deduct such travelling expenses as they may incur provided they are not in receipt of a reasonable travelling allowance. Here again, the receipt of an allowance for travelling expenses disqualifies the employee from claiming any excess expenses unless he can establish that the allowance is not reasonable. In many cases, this can be a difficult task.

Included under the category of travelling expenses are depreciation on the individual's own automobile, if used in travelling. Cost of meals is also included provided that they are consumed during a period of not less than 12 hours while the individual is away from the municipality or metropolitan area where his employer's establishment is located.

From the foregoing remarks, the following general observations will be pertinent:

1. Where an employee is incurring expenses to earn his salary or commission, it would be more advantageous, in many cases, for him to be reimbursed by his employer than to receive an allowance. This is so because all allowances (except reasonable travelling allowances) received by an employee are considered income whereas income from an office or employment is not affected by payments received in reimbursement of expenses incurred on behalf of the employer.

2. Because of the increasingly stringent attitude of the Taxation Division concerning reimbursed expenses, etc., it would be well for employers to make sure that all expense accounts are properly vouchered. If this is not done, there is the possibility that the assessors might attempt to disallow the expenses to the company and to add them to the income of the employee.
3. In the case of salesmen who comply with the conditions previously mentioned, it would often be better for them to receive no allowance for travelling expenses but to arrange to have such financial assistance as they would otherwise receive treated as ordinary remuneration.

While the foregoing interpretation of the Act is perhaps narrower than the present practice of the Taxation Division, it should be emphasized that administrative policies do change from time to time and, in fact, in the past few years have become much more stringent. To a person who is complying strictly with the Act, such changes are no more than a matter of academic interest, which is a very congenial position vis-à-vis the Department of National Revenue. It should also be observed that the special provisions in the Income Tax Act applicable to transportation and other such special types of employees are not dealt with here as they are of less general interest.

THE LAW

Depletion Regulations

The regulations concerning depletion have been amended. The old regulations have been revoked and replaced in full by new regulations which, in some respects, have merely reworded the old rules. The new regulations, which are retroactive to the 1956 taxation year, now make it quite clear that depletion allowances must be computed on the overall profits of all wells or mines operated by the taxpayer as opposed to a well-by-well or mine-by-mine basis. Specifically, the 33-1/3% depletion allowance is permitted on the profits derived from all mineral and oil or gas resources operated by the taxpayer. Added to the list of minerals on which depletion may be claimed are a bituminous sands deposit and halite (rock salt), provided that the latter is extracted by underground mining.

In calculating the aggregate of profits on which the depletion is based, there must be deducted:

a) losses attributable to the production from the resources operated by the taxpayer,
b) exploration and development expenses,
c) capital cost allowance applicable to the property,
d) interest on borrowed money or property used in the taxpayer's production,
e) amounts excluded from the taxpayer's income under the three years' exemption provision,
f) all profits derived from transporting oil or gas.

Canada-Australia Tax Treaty

A tax convention for the avoidance of double taxation has been entered into with Australia but will not come into effect until the necessary instruments of ratification have been exchanged. The convention, which is very similar to the Canada-U.K. Income Tax Agreement, provides, among other things, that profits are taxable

only where a permanent establishment is maintained, and tax in excess of 15% shall not be levied on dividends. Remuneration for personal services will be exempt if an individual resident in one country is present in the other for less than 183 days, performing services on behalf of a resident of the first country.

RECENT TAX CASES

Lobbying Fees

The appellant company exported goods to the United States which attracted a 20% duty. The appellant paid the duty under protest and, subsequently, lodged an appeal to the Customs Court of the United States. The company was advised that the U.S. Customs Court might be influenced if Congress were to pass a bill to allow duty-free importation of this type of goods since it was not entirely clear whether Congress intended the duty to apply. The appellant therefore engaged a registered lobbyist to assist in the promotion of governmental and public interest in the matter. Subsequently, the Tariff Act was amended to permit the duty-free importation of goods similar to those manufactured by the company and, in addition, the appeal to the U.S. Customs Court was successful. As a result, payments aggregating some $17,000 were made to the lobbyist who had helped the company to obtain this advantage.

The Tax Appeal Board ruled that the expenditure under consideration was made once and for all to secure a benefit or advantage that was expected to be enjoyed over an indefinite future period. The purpose which motivated the expenditure was the appellant's desire to pay less duty in the future than he had in the past. Although it turned out that the assessment of duty was incorrect and that more income accrued to the appellant, it was not true to say that the expenditure was made in the process of earning income. The amounts expended produced an enduring advantage for the benefit of the business as a whole and should be regarded as constituting a payment on account of capital, the deduction of which is prohibited. (*No. 489* v. *M.N.R.*)

Progress Payments

A construction company adopted the "completed contract" method of accounting after being instructed by the Department of National Revenue to report its income on an accrual basis rather than on the cash basis previously used. Under this system the company did not take the progress payments received on a contract into income until completion of the contract. The Minister ruled that the progress payments were income subject to tax in the year of receipt and an appeal ensued.

The Tax Appeal Board ruled that income from a business is the excess of the revenues drawn from that business during the year over the year's business expenses and that each progress payment received or receivable was a payment on account of a contract and constituted part of the company's business revenue. The word "profit" in section 4 of the Act must be interpreted to mean the excess of revenue over outlays in a taxation year. The Board was also of the opinion that future expenditures necessary to complete the work did not affect the current determination of taxable income and that for income tax purposes the taxpayer is not permitted to delay recognition of a loss

or profit on a contract until such time as it is completed. The appeal was dismissed. (*Wilson & Wilson Limited* v. *M.N.R.*)

Non-Resident Owned Investment Corporation

The appellant company claimed to be a non-resident-owned investment corporation although part of its income had been described as "commissions earned". The commissions were received for guaranteeing certain loans and the appellant contended that it was income derived from dealing in "bills, notes . . .", etc. and that it also represented a receipt of interest. The Minister claimed that the receipt of such income would disqualify the company from claiming NRO status. The appeal Board ruled that the income in question constituted commissions or fees received by the appellant company for services rendered which did not fall within the provisions of section 70(4) and the appeal was dismissed. (*No. 479* v. *M.N.R.*)

Non-Competition Agreement

Certain assets were purchased by the appellant company from another party who agreed not to compete in any way with the appellant in the manufacture of a certain product for a period of ten years. The company placed a value on this covenant not to compete and claimed capital cost allowance on it as a concession. The Minister disallowed the deduction as did the Appeal Board. It was ruled that the covenant was an intangible concession on the part of the vendor and that the right to be protected from competition did not bear with it the unrestricted and exclusive right to possess something; the right was not property since the character of ownership, which is the indispensable condition of the meaning of the word "property", was lacking. *No. 481* v. *M.N.R.*)

BY J. E. SMYTH, F.C.A.

Students Department

Associate Professor, Queen's University

CORRESPONDENCE

Vancouver B.C.

Sir: I should be interested to learn your views on the following accounting procedures:

(1) On the balance sheet petty cash on hand is deducted from bank overdraft.

(2) In the general ledger accruals for audit fees are credited to Accounts payable account in the closing entries, instead of to Accrued liabilities account.

(3) In the analysis of changes over the year in certain financial statement items, the opening balance is dated December 31, 1956 instead of January 1, 1957.

(4) Income tax assessments for previous years are shown as an addition to the current tax provision for the current year instead of being charged to surplus.

N. R.

Editor's Reply:

(1) As a matter of principle, we do not think that petty cash (or any other asset, such as an account receivable created by over-paying an account payable) should be deducted from a current liability when presented on the balance sheet. The practical effect of this treatment is to suggest that the liabilities are really less than they are; that some part of the debts owing has been settled when such is not the case.

There is, however, another "principle" which seems to have been achieving increasing recognition by the accounting profession. It is that items which are insignificant in amount relative to the other items appearing in the financial statements do not merit a separate presentation – their appearance only tends to obscure the salient points to be brought out in the financial statements. This principle is regarded by some accountants as of a higher order than many other principles and these accountants are, accordingly, prepared to sacrifice theory in the cause of what they regard as a more readily intelligible disclosure of the significant financial information. A small item of petty cash among other current assets of large amount may, for example, have no contribution to make to the interpretation of the balance sheet as a whole.

(2) Many balance sheets are published in which accrued liabilities are grouped with accounts payable, presumably again because a separate presentation of a relatively small amount of accrued liability is not justified. But while this treatment may be acceptable on financial statements, the practice of crediting accrued liabilities and estimated liabilities to accounts payable account in the general ledger is a different matter: the general ledger control account will not agree with the accounts payable subsidiary ledger or voucher register trial balance, as the case may be.

(3) On the side of using a January 1 date, it can be argued that financial statements should never contain any date which does not fall within the period being covered. On the other hand, the use of a December 31 date may emphasize that the current statement starts precisely where the preceding year's statement leaves off. In the past, unfortunately, a January 1 balance shown in the current statements has not always been the same figure as that shown in the financial statements dated December 31, preceding.

(4) In recent years accounting tastes have run to a statement of surplus which shows as few adjustments as possible; for some accountants, the objective is to explain the change in surplus exclusively in terms of reported profit and dividends (the so-called "clean surplus" theory). It is argued that prior year adjustments can properly be included in the income statement for the current year because year after year such items tend to recur (though not always in respect of the same costs) and, looked at in perspective, they really become a customary incident of the total operations of the year in which they are recognized and corrected.

There has always, however, existed another school of thought which takes the opposite view that the final figure on the income statement should reflect only the operations of the current year, with adjustments of profits of prior years being recorded in surplus account (to which the reported profits of prior years have already been credited). This view is sometimes referred to as a "current operating concept" of income. Since neither school has yet succeeded by argument in convincing the other of the merits of its case, the choice of treatment must remain a matter of personal preference.

C.I.C.A. Bulletin No. 14 rejects any presentation of income which permits material adjustments of prior years' operations to affect the figure described on the profit and loss statement as "net profit for the year". The Bulletin does recognize, as an alternative to charges to surplus, a statement of profit and loss in which "net profit for the year" is an intermediate figure, followed by any significant adjustments relating to prior years, and concluding with a figure which might be described as balance carried forward to surplus". The Bulletin states:

> Material adjustments in respect of a prior year's operations call for presentation after the figure of net profit or loss for the current period, if distortion of the results of operations for the period is to be avoided. Such adjustments are in fact adjustments of accumulated surplus, but the choice between showing the adjustments in the profit and loss statement after net profit for the year, or in the statement of earned surplus, is relatively unimportant.

(Readers are invited to submit their comments on, and criticisms of, the editor's reply.)

PROBLEMS AND SOLUTIONS

Solutions presented in this section are prepared by qualified accountants, and reflect the personal views and opinions of the various contributors. They are not designed as models for submission to the examiner but rather as such discussion and explanation of the problems as will make their study of benefit to the student. Discussion of solutions presented is cordially invited.

PROBLEM 1

Intermediate Examination, October 1957

Accounting I, Question 2 (15 marks)

F and G have operated a small manufacturing business on a partnership basis for a number of years. At the present time, the business is in need of funds to provide for the replacement of old equipment and for additional working capital.

The partners are considering the following alternative methods of obtaining funds:

(*i*) Obtain a bank loan secured by a lien on the inventories of the business and by personal notes signed by the partners.

(*ii*) Incorporate as a limited company and sell shares of capital stock to 3 friends who have agreed to invest money in the business on the condition that it is incorporated.

Required:

(*10 marks*) (a) Outline the considerations which the partners should take into account in determining which alternative would be more advantageous from the point of view of financing.

(*5 marks*) (b) What other considerations should they take into account in determining whether to operate as a limited company or as a partnership?

NOTE TO STUDENTS: *Ignore any income tax considerations.*

A SOLUTION

Comparison of the alternative methods of obtaining funds

(1) A bank loan is suitable for temporary financing. A share issue is suitable for long term financing.

(2) If the bank loan is obtained, income must be adequate to meet its repayment with interest over a short period. With a share issue the funds are permanently in the business.

(3) If the business is incorporated and shares issued to outsiders, the partners must consider whether they may lose control or may have to relinquish sole management. This consideration will be affected by the proposed capital structure of the company (e.g. the issue of preference shares).

(4) Before any decision can be made, the partners must consider which method will enable the present financial requirements to be met. There is no point, for example, in deciding upon the bank loan method if sufficient funds cannot be raised in this way.

(5) Bringing in others as shareholders will result in a dilution of profits. Once the bank loan is repaid, all profits will accrue to the partners in their respective shares.

(6) If a bank loan is obtained, the payment of interest will be obligatory. If a company is formed, the payment of dividends will be discretionary.

(7) Additional borrowings will be difficult until the bank loan is repaid. If a limited company is incorporated, there should be no difficulty in obtaining a bank loan in the future to meet temporary requirements.

(8) If a company is formed, F and G as shareholders will have limited liability.

(9) A limited company will have a continuity of existence which a partnership does not have.

(10) Because of the formalities of incorporation, a bank loan can be raised both more quickly and more simply than issuing share capital.

(11) Incorporation involves some expense.

(12) If a company is incorporated, the transfer of the interests in the business is facilitated.

(13) If a company is formed, it will have to comply with the companies act under which it is incorporated. It will have the formalities and expense of preparing annual returns, holding meetings, and recording minutes.

(14) In a partnership, capital may be withdrawn at the discretion of the partners, but in a company capital can only be reduced by complying with the provisions of the Companies Act.

(15) The partners' personal borrowings will be restricted if a bank loan is secured by their personal notes.

(16) Some inconvenience may be caused if a bank loan is obtained because of the need for submitting periodical reports and returns to the bank and the necessity for maintaining an adequate inventory.

(17) It may be possible to retain the partnership form of organization and yet obtain additional capital by proceeding as a limited partnership.

Editor's note: It was not necessary to mention *all* of the above points to secure full marks for an answer to this question.

Examiner's Comments

Some candidates showed that they did not understand the effect of signing personal notes. Some stated that these notes would *also* have to be repaid; others that the notes carried interest in addition to interest payable on the bank loans.

PROBLEM 2

Intermediate Examination, October 1957

Accounting I, Question 3 (15 marks)

H Co. Ltd. operates several hardware stores throughout the country. The following figures relate to a particular branch for the year ended April 30, 1957:

	Cost	Retail
Inventory, May 1, 1956	$ 66,463	$ 98,809
Purchases for year	413,226	724,762
Sales for year		659,178
Freight in for year	14,783	
Returned purchases for year	5,472	8,741
Inventory shrinkage for year		287

During the year, one hundred lawn mowers which were to be retailed for $15 each were marked down 10% of selling price for a special spring promotion. After the sale, the ten which were still unsold were re-priced again at $15.

Eighty-five power tools which were to be retailed for $17.50 each were marked up $2 each when it was learned that the wholesaler's price had increased.

Required:

(6 marks) (a) Your calculation of the inventory at retail and at cost as at April 30, 1957.

(5 marks) (b) Describe briefly, the theory underlying the treatment of mark-downs and mark-ups in determining an inventory valuation at the lower of cost or market.

(4 marks) (c) Outline the advantages of the retail method of inventory pricing for a company of this kind.

A SOLUTION

(a)

H CO. LTD.

CALCULATION OF INVENTORY AS AT APRIL 30, 1957

		Cost	Retail
Inventory April 30, 1956		$ 66,463	$ 98,809
Purchases		413,226	724,762
Returned purchases		(5,472)	(8,741)
Freight in		14,783	–
Mark-ups		–	170
		$489,000	$815,000
(cost ratio = 60%)			
Deductions:			
Sales			659,178
Mark-downs	$ 150		
Less mark-down cancellations	15		135
Inventory shrinkage			287
Total deductions			$659,600
Inventory at retail			$155,400
Inventory at lower of cost or market: 60% x $155,400 =		$ 93,240	

(b) Theory underlying the treatment of mark-downs and mark-ups

The inclusion of mark-ups and the exclusion of mark-downs in determining the cost ratio results in a lower cost ratio and consequently in a lower inventory figure. The result is consistent with accounting theory because,

assuming mark-downs and mark-ups reflect decreases and increases in wholesale prices, respectively:

(i) the exclusion of mark-downs results in a lower cost ratio and therefore reflects the decrease in "market"; and

(ii) the inclusion of mark-ups results in a lower cost ratio and therefore does not reflect an increase in "market".

The method therefore approximates a valuation of inventory on the "cost or market whichever is lower" basis.

(c) **Advantages of the retail method of inventory pricing**

(1) It is possible to calculate inventory figures without taking stock counts or keeping perpetual inventory records.

(2) Because of the possibility of obtaining inventory figures from all branches whenever desired, frequent periodic statements may be prepared. Attention can be directed quickly to branches in which the results are not up to expectations.

(3) The method offers an easy way of handling a great variety of items.

(4) The retail method provides excellent inventory control, and brings to light stock shortages and pilfering, by comparison with physical count.

(5) It is simpler to take a physical count at selling price, and inexperienced clerks may take stock satisfactorily.

(6) Fewer records are required at the branch. Inter-branch transfers are more easily made with stock recorded at retail. The branch manager need not be advised of the cost of the items in stock.

(7) In case of fire, an inventory valuation is easier to establish.

Examiner's Comments

1. A number of candidates did not include freight with purchases when computing accumulated costs.
2. Some candidates included wrong items (e.g. mark-downs and shrinkage) when computing the ratio.

PROBLEM 3

Final Examination, October 1957.
Accounting I, Question 2 (10 marks)

The statement of source and application of funds is recognized as a valuable part of annual financial reports since it helps give the reader insight into past and current financial operating policies.

Required:

Discuss.

A SOLUTION

It has been said that the statement of source and application of funds ranks with the balance sheet and income statement in importance and usefulness. Today, however, only a small minority of published financial statements contain a funds statement. Briefly, here are some of the facts and con-

clusions that may be arrived at from a study of the statement of source and application of funds. They are of particular interest to the shareholder, the prospective investor, to the investment counsel and to management.

(a) Future earning power and future dividends may be dependent on money presently being spent on additions to plant and equipment. Investment counsel firms and financial analysts attempt to estimate the future increase in sales and in profits which will probably result from current plant expansion and will almost completely disregard balance sheet figures for fixed assets. Expenditures on capital items are fairly clear indications of operating policies. They reflect the intentions of the management to keep up with improved production methods and product diversification.

(b) The sources of funds often portray managerial thinking. For instance, there is a tendency on the part of some companies to adopt long term sale and lease back arrangements rather than to assume outright ownership of real estate. Some firms have come to the conclusion that they can secure larger returns on capital invested in actual operations rather than in real estate and equipment. Thus shareholders may benefit from sale and lease back of company properties.

(c) The funds statement will show whether or not financing of company expansion is being provided from earnings or from outside borrowing. Obviously if the financing is internal, the amount of cash available for dividends in relation to earnings will be lower.

(d) The statement shows how working capital has been increased or depleted between balance sheet dates. The other items in the funds statement will then show the reasons for such increase or decrease.

(e) The statement of funds provides information which is essential to a proper understanding of a company's operations and position which cannot be obtained from the statement of profit and loss and balance sheet.

(f) The statement of funds provides a link between balance sheets of successive year ends.

PROBLEM 4

Final Examination, October 1957

Accounting I, Question 3 (16 marks)

H Co. Ltd., incorporated under the Companies Act (Canada), is engaged in retail trade business. Early in December 1956 the management advises CA, the shareholders' auditor, that they propose to obtain authorization to change the company's capital stock structure and to issue a series of first mortgage bonds. The purpose of this plan is to repay the company's bank loan, to pay for the acquisition of all outstanding shares of L Co. Ltd. and of additional buildings and to provide additional working capital.

The terms of the proposed reorganization are as follows:

(i) As of February 1, 1957, the company's authorized capital stock will be changed from 10,000 common shares of a par value of $14 each to:

(1) 3,000 – 5% cumulative preference shares of a par value of $100 each, redeemable at par, and
(2) 25,000 common shares of no par value.

(ii) The newly authorized capital stock will be issued as follows:
(1) 1,700 preference shares in payment of a warehouse.
(2) 9,500 common shares in exchange for the present capital stock.
(3) 9,000 common shares for purchase of all outstanding shares of L Co. Ltd.
(4) 6,500 common shares as a $40,000 partial payment on a new building, the balance of the cost to be settled by the payment of $60,000 cash.

(iii) As of February 1, 1957, the company will issue $450,000 first mortgage bonds maturing serially as follows:

February 1, 1957 to 1960 – 4%	$100,000
February 1, 1961 to 1968 – 4¼%	200,000
February 1, 1969 to 1973 – 4½%	150,000

(iv) It is estimated that the financial expenses of the reorganization will be approximately $20,000.

The accountants of H Co. Ltd. and of L Co. Ltd. have closed the accounts as at November 30, 1956, and have prepared the following post-closing trial balances:

	H Co. Ltd. Dr.	H Co. Ltd. Cr.	L Co. Ltd. Dr.	L Co. Ltd. Cr.
Accounts receivable	$ 55,000		$ 25,000	
Allowance for doubtful accounts		$ 5,000		–
Temporary advances to directors	1,000		–	
Inventories	325,000		75,000	
Prepaid expenses	10,000		2,000	
Land	60,000		35,000	
Buildings	190,000		70,000	
Accumulated depreciation on buildings		45,000		$ 15,000
Equipment	130,000		45,000	
Accumulated depreciation on equipment		105,000		27,000
Accounts payable		90,000		30,000
Accrued charges		35,000		6,000
Taxes payable		7,000		–
Bank loan		214,000		15,000
Capital stock issued and fully paid		140,000		135,000
Earned surplus		130,000		24,000
	$771,000	$771,000	$252,000	$252,000

On November 30, 1956, X Appraisal Co. made an appraisal of the fixed assets of both companies. The depreciated replacement values of the fixed assets of H Co. Ltd. were established as follows:

Land		$ 75,000
Buildings	$250,000	
Less: Accumulated depreciation	65,000	185,000
Equipment	$170,000	
Less: Accumulated depreciation	130,000	40,000
		$300,000

Management wishes that the accounts of H Co. Ltd. be adjusted as at November 30, 1956 to reflect the depreciated replacement values of the fixed assets.

The depreciated replacement values of the fixed assets of L Co. Ltd., established by the appraisers, are approximately equal to the costs less accumulated depreciation recorded in the accounts of L Co. Ltd. Management has, therefore, decided that no adjustments need to be made in the accounts.

The inventories of both companies have been valued at lower of cost or market. However, for H Co. Ltd. cost has been calculated at "average cost", whereas for L Co. Ltd. cost has been calculated at "first in first out" basis. The management wishes that the same basis of cost determination be used for both companies and has suggested that the inventories of L Co. Ltd. as at November 30, 1956 should be adjusted to $72,000 which is the valuation at lower of cost or market with cost being determined on basis of average cost.

Required:

A pro forma consolidated balance sheet as of November 30, 1956, for inclusion in the prospectus covering the issue of shares and bonds.

A SOLUTION

H COMPANY LIMITED
AND ITS WHOLLY OWNED SUBSIDIARY — L COMPANY LIMITED
Pro Forma Consolidated Balance Sheet
as at November 30, 1956

after giving effect to the following transactions:

1. Issue of supplementary letters patent to amend capital stock.
2. Recording appraisal values of fixed assets of H Co. Ltd.
3. Issue of 9,500 no par value common shares in exchange for 10,000 common shares formerly held by shareholders.
4. Issue of 9,000 common shares of H Company Limited to shareholders of L Company Limited in payment of all outstanding shares of L Company Limited.
5. Issue of 1,700 preferred shares in payment of a warehouse.
6. Purchase of a building, payable $60,000 cash and the balance by the issue of 6,500 common shares.
7. Issue of $450,000 first mortgage bonds and use of a portion of the proceeds to pay the bank loan of $214,000.
8. Payment of reorganization expenses of $20,000.

ASSETS

Current Assets		
Cash		$ 156,000
Accounts receivable	$ 80,000	
Less: Provision for doubtful accounts	5,000	75,000
Advances to directors		1,000
Inventories of merchandise — valued at the lower of average cost and market		397,000
Prepaid expenses, at cost		12,000
		$ 641,000

Fixed Assets

Land, building and equipment of H Co. Ltd. valued at depreciated replacement value as determined by X Appraisal Co. at November 30, 1956 plus new buildings at cost $270,000. Land, buildings and equipment of L Co. Ltd. valued at cost

Land		$110,000	
Buildings	$590,000		
Less: Accumulated depreciation	80,000	510,000	
Equipment	215,000		
Less: Accumulated depreciation	157,000	58,000	$ 678,000
			$1,319,000

LIABILITIES AND SHAREHOLDERS' INTEREST

Current Liabilities		
Bank loan		$ 15,000
Accounts payable and accrued charges		161,000
Taxes payable		7,000
		$ 183,000
First Mortgage Bonds		
4%, 4¼%, 4½% maturing serially from 1957 to 1973		
Amount authorized and issued		450,000
Total liabilities		633,000
Shareholders' Interest		
Capital Stock		
Authorized		
3,000 preferred shares, 5% cumulative redeemable at par and of a par value of $100 each	$300,000	
25,000 common shares of no par value		
Issued and fully-paid		
1,700 preferred shares	$170,000	
25,000 common shares	336,000	
	$506,000	
Excess of appraised value of fixed assets over cost	70,000	
Earned surplus	110,000	686,000
		$1,319,000

Editor's Note: The reorganization expenses might have been presented on the balance sheet as a deferred item after fixed assets. The earned surplus would then be $130,000.

BY PETER C. BRIANT, M.B.A., C.A.

Current Reading

MAGAZINE ARTICLES

ACCOUNTING

"PRODUCTION WASTE – ITS NATURE AND ITS ACCOUNTING" by Harold E. Paddock. *The Accounting Review*, January 1958, pp. 50-55.

Industrial waste within a company resulting from excessive labour turnover, ill-health and accidents should ordinarily be reported by a personnel department. The reporting of other causes of internal waste, such as losses from unbalanced seasonal production, inefficient processing of materials, and uneconomic use of supplies, should belong to the accounting department.

The waste accounting system for a company should separate avoidable waste from unavoidable waste costs, relate the units and cost of avoidable waste with its causes, allocate unavoidable waste costs to the current period and to future periods, and provide the data necessary for reports on waste costs for management.

BUSINESS CONDITIONS

"INFLATION IN PERSPECTIVE" by G. L. Bach. *Harvard Business Review*, January-February 1958, pp. 99-110.

The effect of moderate inflation on total real output appears to be slight under most circumstances and not *a priori* predictable. Its impact on the distribution of the national income is also not as great as is often claimed. In fact, the lack of dramatic functional income shifts is one of the significant things emerging from over two decades of inflation.

Figures for the period 1939-1949 reveal, however, that inflation has caused a huge transfer of purchasing power from households to government. Since government bondholders and taxpayers are not identical, taxpayers would appear to be the gainers. But there is little likelihood that the federal debt will be paid off through taxation in the near future. Government bondholders and moneyholders are thus partially expropriated by inflation, and the benefit is distributed over the whole population, with those who buy the most benefiting the most. On balance, savers in fixed dollar value assets are subsidizing spenders.

Our creeping inflation may pick up steam during the next five years, even though it may possibly be interrupted by a business recession. The excess income claims of labour, business and agriculture will persist, and the government will find it extremely difficult not to provide the additional purchasing power needed to support employment at higher cost and price levels.

Exhorting labour and management to moderate their wage and price claims has met with little success. Creating a shortage of total monetary demand, on the other hand, is one sure way of checking inflation. Thus, the real issue is whether the authorities will stand firm and refuse to increase the money supply when the

pressure for higher prices and wages necessitates more purchasing power to prevent falling sales and unemployment. The government must convince the public and the major economic groups within the public that it will act to check inflation, even at the cost of some temporary unemployment and unsold goods. We are not faced with the choice of inflation with full employment, or stable prices with unemployment. The basic issue is whether we shall have stable prices or inflation, with some temporary unemployment in either case.

CONTROL

"DECENTRALIZED OPERATIONS — A CONTROL PROGRAM" by William L. Strong. *The Controller,* January 1958, p. 11 et seq.

An independent oil well service business manages to control operations scattered over a wide geographic area, without destroying the profit motive, by using three primary control tools: individual station income statements; budgets or standards; and the return on investment concept. The station managers are, in effect, in business for themselves and have full profit responsibility for their stations. Their performance is measured by a comparison of actual operating figures with budgeted data. But the true index of a station manager's ability to earn a profit commensurate with the capital committed to his station is the return on investment comparison.

To increase the effectiveness of these control tools, there must be a system of incentive compensation to reward those managers who exceed their profit and return-on-investment objectives. Such compensation must be based on current performance and not on salary, length of service or previous bonuses. The program must also include the following features:

1) Include only station and regional managers.
2) Be based on performance for less than a year; preferably a quarter.
3) Clearly indicate that extra compensation will be awarded only for a performance above that called for by a manager's salary.
4) Measure a manager's performance by comparing actual return on investment with standard.
5) Be readily understandable and easily calculated.

EQUIPMENT

"MACHINE ACCOUNTING AND COMPUTER DEVELOPMENT IN RUSSIA: A FAST-GROWING BRANCH OF INDUSTRY" —Contributed. *The Accountant,* January 11, 1958, pp. 28-30.

A number-one growth industry in the U.S.S.R. is the production of modern business machines ranging from the ten-key adding machines to universal electronic computers.

Now more than a quarter of a century old, the Russian calculating-machine industry is in the midst of an expansion program which began in 1956 and has a target of quadrupling output in five years. If the program is completed as planned, the Russian industry will, in the decade of the 1950's, have increased its output of office-calculating and punched-card business machines 27 times over what it was in 1949.

The output program for electronic computers may be judged from a report that in the next few years, 32 factories will be built for the production of electronic computing machines and the latest types of automatic industrial equipment. The use of computers for accounting purposes ap-

pears to be given a low place on the list of priorities. The production of the first computers specifically designed for accountancy purposes is not planned to take place until 1960.

Mr. Kruschev recently emphasized, however, the importance the Kremlin places on machine accounting. He said management of the national economy was "unthinkable without a unified centralized system of accounting and statistics" and demanded "wide mechanization of accounting, based on machine-calculating stations at offices of the Central Bureau of Statistics".

MANAGEMENT

"Organization for Effective Administration" by J. J. Macdonell. *Cost and Management*, January 1958, pp. 16-25.

In appraising the effectiveness of the organization and administration of an enterprise, at least four factors should be considered: people, organization, planning and control, and methods.

Every business should ensure that it has enough of the right kind of people, that it is not discouraging its innovators, and that each manager and supervisor has a clear idea of his own duties and responsibilities and those of the people under his direction. An unwillingness to make decisions without reference to a higher authority usually indicates that the top manager has not delegated a proper amount of authority and responsibility.

Fundamental to the efficient operation of a business is the existence of a formal plan of organization through charts, manuals, or definitions of duties and responsibilities. One common test of the adequacy of the plan is the observance of the span of control. It is better to err on the side of too wide a span of control. Too short a span often results in a vertical organization in which the chain of command becomes burdensome. Another test often applied is the use of staff specialists. Technical people should not be overly burdened with administrative detail and paperwork. On the other hand, enough staff departments and specialists should be used to enable the managers to have time to think.

Any kind of budgetary control or planning system that is not thoroughly understood by every level of management and supervision is usually ineffective. It tends to become merely an interesting exercise for the accounting department or even an expensive and useless periodic activity in which everyone engages. All company reports should be reviewed critically from time to time and their use and value questioned.

Administrative methods should be reviewed regularly either by a staff department or by an outside consultant. But undue emphasis should not be given to installing new and better equipment to cut office costs. What is a great deal more important is the intelligent appraisal of the procedures themselves. The tangible economies produced by methods are also not as important as those produced through the introduction of more effective organization planning and more capable people.

BOOK REVIEWS

Canadian Income Tax for Accountants, by W. G. Leonard; CCH Canadian Limited; 406 pages; $7.50.

This is a text book designed primarily for students outlining the provi-

sions of the Income Tax Act and Regulations in non-technical language. The subject matter is confined to the Income Tax Act and does not deal with the various provincial taxing statutes. The author has followed closely the construction of the Act itself, with only relatively minor rearrangement in the order, and concentrates mainly on providing an explanatory outline of the Act as a whole rather than dealing exhaustively with the interpretation or implications of particular provisions. The treatment is comprehensive in that very little that is contained in the Act escapes mention. The result is a text which should be particularly useful for students and others interested in becoming better acquainted with the structure and content of the Income Tax Act.

On the whole the job of converting the language of the statute into readable English has been successful. The material is liberally supplied with clear subject headings and each chapter is preceded by a useful table of contents. The author has also reproduced many of the forms prescribed for various purposes under the Act. Some examples are given illustrating the effect of provisions which are complicated to explain in words, although more of these might have been useful. It is to be hoped that this text will be revised from time to time to deal with changes in legislation as they occur.

Most accountants will be sympathetic with the author's general comments on the determination of income for taxation purposes which suggest, in effect, that a tax which calls itself an "income tax" should be based on income as determined by generally accepted rules of business and accounting practice. The author also suggests that a tribunal of some kind other than a court of law be established to settle disputes concerning the yearly measurement of income from businesses.

This book has obviously been designed for students as an introduction to further study of the Act and as a guide to the meaning of its provisions. Because of its close adherence to the construction of the Income Tax Act it is well suited to this purpose. It is not intended for those who require only a general understanding of the subject as a whole or the answers to specific problems. Mr. Leonard is to be congratulated on producing a most worthwhile addition to the limited amount of published material dealing with the Canadian income tax system.

KERR GIBSON, C.A.
Toronto, Ontario.

"The Interpretation of Accounts", by F. Sewell Bray; published for the Incorporated Accountants Research Committee by the Oxford University Press; pp. 215; $4.50.

"First and foremost I am an accountant and what I say will be coloured by that background." So says Professor Bray in this series of lectures and, as a chartered accountant who has practised in London for many years, he may well claim to speak as an accountant to accountants. But he is also the First Stamp-Martin Professor of Accounting, and he admits his own mental preferences favour economics and philosophy. He is a man trained in economic theory and perhaps the greatest contribution of this book to the accounting profession is that it advances from traditional accounting well along the road that links it to economics.

It is to be feared, for this very rea-

son, that the book will not reach the vast majority of Canadian accountants. To appreciate it the reader must have an open mind and a freshness of outlook which will give sympathetic consideration to any attempt to break from the shackles of accounting tradition in this age of change. It must be admitted also that Professor Bray has not altogether succeeded in eliminating from his writing economic jargon that will be incomprehensible to most accountants – not only economic jargon, either, but such passages as "the equivalence of symbolic aggregates expressing measurements of logical concepts." Plainer speech would bring him nearer to his audience.

In this inaugural lecture Professor Bray admirably sets the standards which alone can justify the professional status of accounting. He affirms his belief in accounting as an intellectual discipline, an applied art which, in his later lectures, he prefers to regard as a science. It is something of a triumph for academic discussion, in his opinion, that such matters as the accounting implications of changing money values have been discussed to the extent that they have been in the world of practical affairs, and he refers to the few enlightened companies which provide for depreciation on the basis of replacement values. Indeed it is only in such cases that he can see any real merit in the enforced disclosure of the actual amount of the imputed charge.

Professor Bray seeks to resolve financial accounting, for significant interpretation of results to management, into a series of change accounts. "It may very well turn out", he says, "that change accounts are the vital link between historical accounting and expectation accounting". He introduces a saving and asset formation account as the first of a series of capital change accounts, comprising in total the statement of source and application of funds as commonly found in North America. Following on savings and asset formation, the further subdivisions of capital change account are capital gains and losses (including bad debts), long term financial changes, working capital changes, tax adjustments and changes in provisions and liabilities, and summary account of capital changes. The latter provides columns for comparison of actual with expected standards and the difference between the two. Entrepreneurs are able thus to compare results with intentions and consider the extent of justification for differences.

In the second part of the book Professor Bray considers direct taxation, auditing theory and social accounting. These lectures are related to but outside the main stream of thought of the others, though in social accounting, as he says, accountants, economists and econometricians to some extent come together.

In a book which comprises a series of lectures given over a period of several years there is bound, no doubt, to be a good deal of repetition and the progression of thought does not always seem to be made economically. Nevertheless, to the thinking accountant on both sides of the Atlantic, this book represents the current trend of development in accounting and it brings the economist and the accountant very much closer together than they are at present. That this is a development "devoutly to be wished" can hardly be disputed.

PROF. KENNETH F. BYRD, C.A.
McGill University, Montreal

NEWS OF OUR MEMBERS

Alberta

Nash & Nash, Chartered Accountants, announce the removal of their offices to the Canada Trust Bldg., 528—8th Ave W., Calgary.

John Goldberg, C.A. announces the opening of an office for the practice of his profession at 205 Mercantile Bldg., Edmonton.

British Columbia

Rudd & Goold, Chartered Accountants, announce the opening of an office for the practice of their profession at Galloway Bldg., 220—4th Ave., Kamloops. Gordon D. Elliott, C.A. will be resident partner.

Gunderson, Stokes, Walton & Co., Chartered Accountants, and Wilfrid L. Peaker, B.Sc. Acc., C.A., announce the amalgamation of their practices. The combined practices will be carried on at Ste. 101 Lougheed Bldg., 303 Martin St., Penticton, with Mr. Peaker as resident partner.

Manitoba

Price Waterhouse & Co., Chartered Accountants, announce the removal of their Winnipeg offices to Canada Trust Bldg., 232 Portage Ave.

New Brunswick

George Simons, C.A. has been appointed comptroller of Pfizer Canada Division of Pfizer Corporation, Montreal.

Ontario

Gordon C. Tilley, C.A. has been appointed a director of W. Wallace Muir & Associates Ltd., Ottawa.

A. C. Lawson, C.A. has been appointed secretary-treasurer of Babcock-Wilcox and Goldie-McCulloch Ltd., Galt.

Humpage, Taylor & McDonald, Chartered Accountants, announce the formation of a partnership with J. Adrian Langhorne, C.A. Henceforth the practice of their profession will be conducted under the firm name of Langhorne, Taylor & McDonald, Chartered Accountants, with offices at 262 Division St., Cobourg.

M. R. Rankin, C.A. has been appointed to the Board of Directors and promoted to the office of assistant secretary and treasurer of the Marlette Coach Company, Marlette, Michigan.

Quebec

Ruby & Manolson, Chartered Accountants, 1117 St. Catherine St. W., Montreal 2, announce the admission to partnership of Philip Madras, C.A.

Philip S. Rosen, C.A. announces the removal of his office to 5757 Decelles Ave., Montreal.

Georges R. Gagnon, C.A. announces the opening of an office for the practice of his profession at 12167 Ste. Gertrude Blvd., Montreal North.

Richter, Usher & Vineberg, Chartered Accountants, Montreal, announce the admission to partnership of Marvin M. Corber, C.A.

The editor welcomes information for this column. News of members and provincial Institutes' activities received up to and including the 13th of the month will appear in the following issue of the journal.

INSTITUTE NOTES

MANITOBA INSTITUTE

A dinner meeting of the members of the Manitoba Institute was held on March 10 at the Royal Alexandra Hotel, Winnipeg. Feature of the evening was a panel on the Manitoba Companies Act under the chairmanship of J. S. Swinden. Panelists were R. G. B. Dickson, Q.C., C. V. McArthur, Q.C., D. J. Campbell and W. H. Gray.

NOVA SCOTIA INSTITUTE

The semi-annual meeting of the Nova Scotia Institute took the form of a convocation dinner and dance on March 7 at the Lord Nelson Hotel, Halifax. Fourteen successful candidates were presented with their certificates by George Hudson, Atlantic Provinces regional representative of the Canadian Institute. Special prizes were awarded for the highest marks in the final, intermediate and primary examinations to R. H. Henley, J. D. Flinn and C. G. Carson, respectively. Hon. G. I. Smith, Minister of Highways and Provincial Secretary of Nova Scotia, was the speaker at the convocation.

QUEBEC INSTITUTE

***School Speaker Program*:** By March 10 members of the school speakers committee had fulfilled engagements in seven French and six English high schools in the Montreal area. In addition, Institute speakers addressed high school classes in Sherbrooke and Valleyfield. Second and fourth year classes at McGill University also were covered in the program. In most cases the presentation included a story of the advantages of being a chartered accountant, a showing of the film, "Accountancy — the Language of Business" and a question and answer period. School speeches constitute one of the activities in the Institute's recruitment program and are carried on by a committee under the joint chairmanship of P. S. Leggat and A. G. Leroux.

***Students Society*:** On February 17 the first of a series of discussion meetings sponsored by the Students Society was held in the Institute assembly hall. The well-known lawyer and tax consultant, H. H. Stikeman, Q.C., spoke on "Capital Gains".

The annual winter outing of the Students Society took place on February 22 at Morin Heights in the Laurentian mountains. Attended by more than 100 members, the outing included a sleigh ride, ski races, dinner and dancing.

ONTARIO INSTITUTE

***Members by Affiliation*:** The following applicants have been admitted to membership by affiliation: D. R. Drummond (Que. '48), A. M. Findlay (Scot. '55), W. D. Gillman (Eng. '47), R. F. Hawkes (Eng. '48), A. A. Hinderer (Inc. '57), W. H. Huels (Que. '56), C. J. Leslie (Scot. '53), Paul Massé (Que. '57), K. J. McKenna (P.E.I. '53), S. M. Milne (Man. '34), S. M. Reinblatt (Que. '50), G. Rodgers (Inc. '52), J. Schwartz (Que. '53), R. G. Scott (Man. '56) and J. Silver (Inc. '55), R. C. Berry (Que. '41), J. B. Flett (Scot. '52), T. Hughes (Eng. '46), I. A. P. Michaelson-Yeates (Eng. '55), L. Copestick (Scot. '51), S. H. Alexander (Eng. '38), C. W. Ashley (Eng. '56), N. D. Gough (Eng. '47), E. Houston (Scot. '55), A. E. Ayre (Eng. '50), B. C. Briand (Que. '53), J. R. Brown (B.C. '53), W. Caplan (Eng. '50), H. W. Cureton (Eng. '57) and A. C. Dolden (Que. '51).

The following applicants were also admitted to membership under By-law 4(c): A. A. Boyce (C.P.A. N.Y. '50), A. A. Cook (C.P.A. Ohio '50), V. P. Cranna (Cape Soc. '48) and A. Wassyng (Transvaal '57).

***Professor F. R. Crocombe*:** Retiring in June 1958 after 29 years teaching at the University of Toronto, Professor Frederick Reginald Crocombe was the guest of honour

at a banquet in the Great Hall of Hart House, Toronto, on March 5. Over 190 graduates, staff and students gathered to pay tribute to him and enjoy some of the recollections and incidents of his busy career. Professor Crocombe joined the staff of the Department of Political Economy in 1929. Since then some 300 of his students in accounting have became chartered accountants. In recognition of his distinguished service to the profession, the Institute elected him a Fellow in 1956. In arranging the banquet the Commerce Club thoughtfully decided to establish a student bursary fund in his name. The fund will be available for loans to Commerce students at the University of Toronto. Contributions payable to the University of Toronto will be welcome, particularly from graduates, and should be sent to the Commerce Club.

Library: Recent additions are — "Accounting — A Social Force in the Community" by M. E. Murphy; Melbourne University Press, 1956; pp. 208. "Accounting for the Meat Packing Business" by H. G. Greer and D. Smith; Institute of Meat Packing, 1954; pp. 274. "Cost Accounting" 2nd edition; by A. Matz, O. J. Curry, and G. W. Frank; South Western Publishing Co., 1957; pp. 838. "Estate Planning" Special Lectures, 1957, of Law Society of Upper Canada; Richard De Boo, 1957; pp. 288. "Should Small Business Incorporate?" by A. B. Monteith; Canadian Institute, 1957; pp. 7. "The Technique of Clear Writing" by R. Gunning; McGraw Hill Company, 1952; pp. 289.

75th Anniversary: February 1, 1958 marked the beginning of the 75th year of the Institute as an incorporated body under a special Act of the provincial legislature. The Institute was founded on November 11, 1879 and called "The Institute of Accountants and Adjusters of Canada". The members were concerned with establishing an association "whose opinions shall be authoritative on all matters in connection with accounts and bookkeeping; and the raising of the status of the profession by testing the abilities of all candidates for admission to membership". On February 1, 1883, the efforts of the young Institute were rewarded by the assent of the Lieutenant Governor to the charter of the Institute.

The Council recently commissioned F. S. Challener, R.C.A., to paint a picture representing the meeting of the Council of the Institute on December 19, 1882, at which the petition for incorporation was approved. The picture is reproduced in this issue of *The Canadian Chartered Accountant* following the editorial. The picture hangs in the Council Chamber of the Institute, and members are invited to view it.

Annual Conference, London 1958: The third annual conference of the Institute will be held at the University of Western Ontario on Monday, June 16, and Tuesday, June 17, 1958. R. B. Taylor of Hamilton is chairman of the Program Committee.

The program will commence with a morning devoted to the "Principles of Administration" under the direction of Professor J. C. Taylor. The annual meeting will take place on Monday afternoon, followed by a reception and dinner at which Professor F. W. P. Jones, Dean of the School of Business Administration, will be the speaker.

Tuesday morning will consist of two sessions with alternatives. The first will be "Sales Looks at Accounting" by G. F. R. Plummer, F.C.A., or "The Audit as a Basis for Further Services to Clients" by a panel with R. B. Davis, F.C.A., as chairman. The second session will be a talk on "Interpreting the National Accounts of Canada" by F. L. Norwood, C.A., or "The Verification of Inventories" by a panel of practising members. After luncheon Mr. Robert A. McDougall, B.A. will present a paper on "Operations Research" and the significance of this technique to chartered accountants.

A detailed program and registration form will be mailed to members early in May.

B.C. INSTITUTE

C.A. Club of Vancouver: William M. Mercer, president of Wm. M. Mercer Ltd., pension consultants, was the featured speaker at the second luncheon meeting of the club held in the Hotel Georgia, on March 3, 1958. Framed membership certificates were distributed to charter members present.

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VANCOUVER CLUB OFFICERS

Left to right: Roy A. Shand, vice-president; Gilbert C. P. Gray, president; Dick Schulli, secretary; J. H. Carter, treasurer.

The following luncheon meeting dates have been tentatively scheduled for the balance of 1958: Wednesday, April 2; Monday, May 12, June 2, July 7, August 4; Tuesday, September 2; Monday, October 6, November 3, December 1. A "post tax-deadline" smoker is planned early in May.

School Counsellors Meet: Members of the B.C. Institute's Committee on Attracting Students, headed by Don Fields, met on Friday, March 7, 1958 with high school counsellors from the Greater Vancouver and Lower Fraser Valley areas. At the conclusion of an evening of brisk discussion on making opportunities in the field of the chartered accountant more meaningful to high school students, the school counsellors were presented with portfolios containing informative material on training and opportunities for students in articles.

C.A. Wives Club of Vancouver: The inauguration of the Chartered Accountants Club of Vancouver will shortly be paralleled by the birth of a Chartered Accountants Wives Club.

A coffee party for members' wives was held on Wednesday, March 26, 1958, at the Royal Vancouver Yacht Club.

ONTARIO STUDENTS

Winter Meeting: The regular monthly meeting of the Chartered Accountants Students Association of Ontario was held in the lecture hall of the Chartered Accountants Building on February 27, 1958. Mr. J. B. McGeachy, well known war correspondent, journalist and lecturer, discussed "Canada and World Affairs". Mr. McGeachy's topic was well received by the 40 students in attendance, and in the refreshment period following, many students asked and obtained his opinions on questions regarding world affairs.

EDMONTON C.A. CLUB

Certificates were presented to 20 new members of the Alberta Institute in the Northern Jubilee Auditorium, Edmonton, on January 10, 1958. Joseph G. Simonton, president of the Alberta Institute, was master of ceremonies, and Gilbert E. Gee, vice-president and chairman of the Education Committee, awarded a prize and medal to William W. Winspear for highest standing in the final examination, and prizes to Donald J. Duncan and Rolf Hattenhawer for highest standings in the intermediate and primary examinations, respectively. James A. deLalanne, C.I.C.A. president, delivered an address to the new members and their invited guests. A tea and informal reception followed.

In the evening, the Edmonton Club sponsored a "New Members' Night" dinner and dance at the Mayfair Golf and Country Club. New members and their guests were greeted by club president S. A. Long.

A full slate of season's activities has been planned by the Edmonton Chartered Accountants Club. These include a luncheon meeting, midseason dance, "post-tax" stag, panel discussion, golf tournament and entertainment for the forthcoming provincial conference to be held in Edmonton in the spring.

C.A. CLUB OF OTTAWA

Mr. J. A. de Lalanne, president of the C.I.C.A., was guest speaker at a luncheon meeting of the club held on February 13, 1958.

WATERLOO-WELLINGTON C.A.'s

February 25 was charter night for the Waterloo-Wellington Chartered Accountants Association, with 43 local C.A.'s attending a meeting at the Granite Club in Kitchener. Speakers were W. I. Hetherington, president of the Ontario Institute, and W. G. Thompson of the Hamilton and District C.A. Association.

OBITUARIES

EDMOND GUNN

The Institute of Chartered Accountants of Ontario announces with regret the death at the age of 93 of Edmond Gunn at his home in Toronto on January 21, 1958.

Mr. Gunn was born in Niagara Falls in 1864 and began his career in Hamilton. He was admitted to membership in the Institute in 1898 and established the Toronto firm of Gunn, Roberts & Co., Chartered Accountants, in 1906. He retired as senior partner of the firm in 1949.

Mr. Gunn was the president of the Ontario Institute in 1914 and was admitted as a Fellow in the same year. In 1933 he was made a life member.

The Institute owes a great debt to Mr. Gunn for his continued interest and guidance of its affairs over many years. To his daughter the president and council extend their sincere sympathy.

J. EARLE L. SMITH

The Institute of Chartered Accountants of Ontario regrets to announce the death of J. E. L. Smith, in Toronto on January 2, 1958.

Born in Simcoe County in 1889, Mr. Smith commenced his business life in Hamilton and later moved to Toronto where he was with Price Waterhouse & Co. In 1924 he was admitted to membership in the Institute. After a short period with a mortgage company he established his own practice in Toronto which he carried on until his death. Always interested in the Institute's affairs he attended the annual meetings and conferences regularly.

To his wife and family the members of the Institute extend their sincere sympathy.

WILLIAM ARCHIBALD CAMERON

The Institute of Chartered Accountants of Ontario announces with regret the death of W. A. Cameron of Thornhill at Daytona Beach, Florida. Mr. Cameron was born in Saint John, New Brunswick in 1887 and came to Toronto in 1920. He became a member of the Institute in 1924. For many years he was a partner of Deloitte, Plender, Griffiths & Co. and retired about five years ago. He was a member of the Toronto Club, the Toronto Golf Club and of Zetland Lodge of the Masonic Order.

To his wife and family the Council and the members of the Institute extend their sincere sympathy.

JOHN D. U. WILLIAMS

The Alberta Institute regrets to announce the death of John David U. Williams of Calgary in November, 1957. Mr. Willams became a member in 1930 and was affiliated at first with Williams and Stuart which later became Williams, Roberts and Company.

The members of the Institute extend sincere sympathy to his wife.

GORDON THOMAS MEREDITH

A prominent practising member, Gordon Thomas Meredith, passed away in Vancouver on December 30, 1957.

Born in Melita, Manitoba, in 1906, Mr. Meredith attended school in Vancouver. In 1927 he articled with Mrs. M. E. Crehan, of the pioneer B.C. firm of Crehan, Mouat & Co., and qualified for membership in the B.C. Institute in November 1932. The partnership of Crehan, Meredith & Co. was formed in 1936. In 1952, the firm of Meredith, Bruce, Baldwin and Kitto was formed by amalgamation.

Mr. Meredith served on council from 1944 to 1947, during which time he was active in the work of the Committee on Education and Examinations and of the Special Committee for Post-War Rehabilitation set up to expedite training for veterans.

Our deepest sympathy is extended to Mr. Meredith's widow, his two sons, and his mother.

HANNES JOHN PALMASON

The Institute of Chartered Accountants of Manitoba announces with deep regret the death on January 6, 1958 of Hannes John Palmason at the age of 70.

Born in Parry Sound, Ontario, Mr. Palmason was admitted to membership in the Institute of Chartered Accountants of Saskatchewan in 1913 and became a member of the Manitoba Institute in 1918. After a number of years with practising firms in Winnipeg, he became comptroller of Marshall Wells of Canada Ltd. During the Second World War he was with the Department of National Defence – Naval Service, Ottawa, and in 1944 he returned to Winnipeg to practise on his own account.

To his wife and family, the members of the Institute extend their sincere sympathy.

J. W. ROLAND LEVESQUE

L'Institut des Comptables Agréés de Québec annonce avec un profond regret la mort de J. W. Roland Levesque le 14 décembre 1957.

Né en 1908 monsieur Levesque a fait ses études à l'université Laval et plus tard suivit des cours à l'Ecole des Hautes Etudes Commerciales de Montréal en vue de devenir comptable agréé. Il a été admis membre de l'Institut en juin 1932. Peu après il formait la firme de Roland Levesque & Cie dont il demeura l'associé jusqu'au moment de sa mort.

A Madame Levesque ainsi qu'à la famille, les membres de l'Institut et le conseil expriment leur sincère sympathie.

J. A. MONTREAUIL

L'Institut des Comptables Agréés de Québec annonce avec un profond regret la mort de J. A. Montreauil au mois d'août 1957.

Monsieur Montreauil est né le 20 septembre, 1890 et a été admis comme membre de l'Institut des Comptables Agréés le 17 avril, 1946. Monsieur Montreauil a eu une longue et belle carrière dans les affaires du gouvernement.

A Madame Montreauil ainsi qu'à la famille, les membres de l'Institut et le conseil expriment leur sincère sympathie.

J. ARTHUR L'HEUREUX

L'Institut des Comptables Agréés de Québec annonce avec un profond regret la mort de J. Arthur L'Heureux le 10 février, 1958.

Monsieur L'Heureux est né le 9 février 1882 et a été admis comme membre de l'Institut des Comptables Agréés de Québec en novembre 1907. Il fut un des premiers membres canadien-français de l'Institut. Il a fait partie du personnel MacIntosh, Hyde, Comptables Agréés, durant dix sept années pour ensuite être à l'emploi du gouvernement pour une période de treize ans. En 1946 il formait la compagnie L'Heureux & L'Heureux, Comptables Agréés. Il s'était retiré des affaires en 1955.

Les membres de l'Institut expriment leurs sincères condoléances à Mme L'Heureux ainsi qu'à la famille.

PAUL E. CARRIER

L'Institut des Comptables Agréés de Québec annonce avec un profond regret la mort de Paul E. Carrier au mois de janvier, 1958.

Monsieur Carrier est né en 1901 et a été admis comme membre de l'Institut des Comptables Agréés de Québec le 4 mai, 1948. Au moment de sa mort Monsieur Carrier travaillait à son propre bureau à Joliette, Qué.

A Madame Carrier ainsi qu'à la famille, les membres de L'Institut et le Conseil expriment leur sincère sympathie.

C. RENE DUFRESNE

L'Institut des Comptables Agréés de Québec annonce avec un profond regret le décès de C. René Dufresne le 3 janvier 1958.

Monsieur Dufresne était un gradué de l'Université de Montreal et a été admis comme membre de l'Institut des Comptables Agréés de Québec le 25 juin 1929.

Monsieur Dufresne a été associé dans la compagnie Lortie, Dufresne & Cie pendant de nombreuses années, et en 1940 il ouvrait son propre bureau jusqu'au moment de sa mort.

A Madame Dufresne ainsi qu'à la famille, les membres de l'Institut et le conseil expriment leur sincère sympathie.

CLASSIFIED ADVERTISEMENTS

All replies to box numbers should be sent to The Canadian Chartered Accountant, 69 Bloor Street East, Toronto 5, Ontario.

Rates: *Positions wanted, $7.00 per column inch; Positions offered, $10.00 per column inch; Open rate, $17.00 per column inch.*

Closing date is 13th of preceding month.

STUDENT WANTED: Intermediate for office in St Hyacinthe, Quebec. French speaking. Good opportunities for advancement. Please contact by correspondence to Jacques R. Gauthier, C.A., 1455 Cascades Street, St. Hyacinthe, P.Q.

CHARTERED ACCOUNTANT aged 36, presently employed in Quebec at five figure salary, with eight years diversified industrial experience including standard costs, budgetary control and production control seeks position in southern Ontario. Preferably outside Toronto. Would consider suitable offers from industrial *or* professional firms. Available May. Please write for further information to Box 754.

CHARTERED ACCOUNTANT with five years experience in department of National Revene, Taxation Division, desires part-time employment in Toronto area with practising member for nights and week-ends. Would also consider permanent position in tax department of large concern. Box 755.

POSITION WANTED: Recent graduate, B.Comm., age 36, ten years experience in manufacturing in Ontario, desires position with firm with early possibilities of partnership. Box 756.

CHARTERED ACCOUNTANT, age 35, seeks position with small or medium-size firm leading to partnership or succession agreement. Box 758.

WANTED: A medium-sized accounting practice in Ontario through purchase or succession agreement. Box 757.

PRACTICE WANTED: Chartered accountant wishes to purchase accounting practice in Edmonton. Partnership or succession agreement considered. Box 759.

ACCOUNTING PRACTICE WANTED in Montreal by purchase or succession agreement. Box 706.

CHARTERED ACCOUNTANT: The University of British Columbia invites applications from chartered accountants holding a University degree for the position of Instructor in Accounting in the Faculty of Commerce and Business Administration. Initial salary of $5,000 or higher, depending on experience and qualifications. Appointment to be made from June 30, 1958. Reply, giving full particulars as to academic background, experience and age, not later than April 30, 1958, to

The Dean of the Faculty of Commerce and Business Administration,
University of British Columbia,
Vancouver 8, B.C.

VANCOUVER FIRM of chartered accountants, has vacancies for intermediate and senior students. Starting date to your convenience during 1958. Interviews arranged in your locality. We require top calibre men only and will pay accordingly. Our staff has been notified of this advertisement. Box 760.

CHARTERED ACCOUNTANT presently located in Toronto seeks partnership or employment leading to partnership. Extensive experience in commercial and all branches of public accounting. Capital available. Any location considered. Box 761.

ACCOUNTANTS: Large utility requires two chartered accountants (or certified public accountants) who are interested primarily in opportunities for development and advancement. Applicants preferably should be between 30 and 35 years of age, with a few years' experience in industry. A mathematical and analytical background would be desirable for one of these positions.

Please reply giving qualifications, experience and starting salary expected to Box 762.

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STEWART, SMITH & MACKEEN

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Roy Building - - - - - Halifax, N.S.

ROSS & ROBINSON

Barristers and Solicitors

Canadian Bank of Commerce Chambers - Hamilton, Ont.

BORDEN, ELLIOT, KELLEY, PALMER & SANKEY

Barristers and Solicitors

25 King Street West - - - - - Toronto 1, Ont.

McCARTHY & McCARTHY

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Barristers and Solicitors

67 Yonge Street - - - - - *Toronto 1, Ont.*

BEAULIEU, BEAULIEU & CASGRAIN
Barristers and Solicitors

Kent Building, 10 St. James Street East - *Montreal 1, Que.*

COMMON, HOWARD, CATE, OGILVY, BISHOP & COPE
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